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1966

CANADA

REPORT

OF THE

ROYAL COMMISSION ON

TAXATION

VOLUME 1

INTRODUCTION, ACKNOWLEDGMENTS AND MINORITY REPORTS

1966

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CANADA

TO HIS EXCELLENCY

THE GOVERNOR GENERAL IN COUNCIL

MAY IT PLEASE YOUR EXCELLENCY

We, the Commissioners, appointed as a Royal Commission in accordance with the terms of Order in Council P.C. 1962-1334, dated 25th September, 1962, to inquire into and report upon the incidence and effects of taxation imposed by Parliament, and such other related matters as are set forth in the above-mentioned Order in Council:

BEG TO SUBMIT TO YOUR EXCELLENCY THE ACCOMPANYING REPORT, AS WELL AS SEPARATE MINORITY REPORTS OF COMMISSIONER BEAUVAIS AND COMMISSIONER GRANT.

K. LeM. Carter
Chairman

J. H. Perry
Commissioner

André Beauvais
Commissioner

D. G. Grant
Commissioner

Eleanor L. Milne
Commissioner

Charles Walls
Commissioner

December 22, 1966

THE ORDER IN COUNCIL

P.C. 1962-1334

Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 25th September 1962.

The Committee of the Privy Council, on the recommendation of the Right Honourable John George Diefenbaker, the Prime Minister, advise that:

Mr. Kenneth LeM. Carter

Mr. J. Harvey Perry

Mr. A. Emile Beauvais

Mr. Donald G. Grant

Mrs. S. M. Milne

Mr. Charles E. S. Walls

be appointed Commissioners under Part I of the Inquiries Act, to inquire into and report upon the incidence and effects of taxation imposed by Parliament, including any changes made during the currency of the inquiry, upon the operation of the national economy, the conduct of business, the organization of industry and the positions of individuals; and to make recommendations for improvements in the tax laws and their administration that may be consistent with the maintenance of a sufficient flow of revenue; and without restricting the generality of the foregoing, the Commission shall consider and report upon:

(a) the distribution of burdens among taxpayers resulting from existing rates, exemptions, reliefs and allowances provided in the personal and corporation income taxes, estate taxes and sales and excise taxes, taking into account also the jurisdiction and practices of the provinces and municipalities;

(b) the effects of the tax system on employment, living standards, savings and investment, industrial productivity, and economic stability and growth;

(c) provisions in existing laws which may have given rise over the years to anomalies or inequities or which may require action to close loopholes which permit the use of devices to avoid fair taxation;

(d) the effects of the income, sales and excise taxes and estate duties on income and investment flows which affect the balance of international payments and economic relations with other countries;

(e) the means whereby the tax laws can best be formulated to encourage Canadian ownership of Canadian industry without discouraging the flow of investment funds into Canada;

(f) the changes that may be made to achieve greater clarity, simplicity and effectiveness in the tax laws or their administration; and

(g) such other related matters as the Commissioners consider pertinent or relevant to the specific or general scope of the inquiry.

The Committee further advise:

1. That the Commissioners be authorized to exercise all the powers conferred upon them by section 11 of the Inquiries Act and be assisted to the fullest extent by Government departments and agencies;

2. That the Commissioners adopt such procedures and methods as they may from time to time deem expedient for the proper conduct of the inquiry and sit at such times and at such places in Canada as they may decide from time to time;

3. That the Commissioners be authorized to engage the services of such counsel, staff and technical advisers as they may require at rates of remuneration and reimbursement to be approved by the Treasury Board;

4. That the Commissioners report to the Governor in Council with all reasonable despatch, and file with the Dominion Archivist the papers and records of the Commission as soon as reasonably may be after the conclusion of the inquiry; and

5. That Mr. Kenneth LeM. Carter be Chairman of the Commission.

R. B. Bryce,
Clerk of the Privy Council.

CANADA

REPORT

of the

ROYAL COMMISSION ON TAXATION

CONTENTS OF THE COMPLETE REPORT

ROYAL COMMISSION ON TAXATION

VOLUME 1

C O N T E N T S

PREFACE

An examination of Order in Council P.C. 1962-1334 clearly shows that there is no aspect of federal taxation outside our purview; for the terms of reference invite us to consider all economic, administrative and equity questions that relate to the taxes levied by Parliament.

We recognize that there are areas which we are not asked to consider: we have not been asked to inquire into the taxes imposed by provincial and municipal governments, nor have we been asked to make recommendations with respect to the level or composition of federal government expenditures. Rather we are to consider how "a sufficient flow of revenues" can best be raised for purposes of the federal government.

We have no quarrel with these restrictions. Indeed, we recognize that without them our task would be impossibly large. However, many of the questions we are explicitly asked to consider have implications for these excluded areas and changes in the excluded areas have implications for the questions we must consider. We have tried to interpret our terms of reference broadly enough that vital issues closely related to our immediate and obvious concern are not overlooked. After consideration we have decided to make the following assumptions with respect to our terms of reference.

1. Our first assumption relates to the definition of a tax. Under most definitions, tariffs would be considered taxes as would a lottery or the prices charged for the provision of goods and services by government monopolies such as the Post Office. But to use these definitions would extend our terms of reference to the areas of commercial policy and the operation of government enterprises, areas that we do not believe we are expected to cover and that could not be covered adequately with the staff and time available. We therefore define our terms of reference to exclude both questions.

2. Our second assumption relates to the areas of federal-provincial relations. While our terms of reference make no explicit reference to this area, we feel that we would be derelict in our duty if we submit a Report that ignores this vital aspect of Canadian life. The relations between the various levels of government are currently in a process of dramatic change that is likely to continue to evolve for some time to come. These changes will vitally affect the Canadian fiscal system. We feel that it is incumbent upon us to recognize what we believe to be the objectives in federal-provincial relations and to strive to develop a tax structure that is consistent with their realization. We will, however, stop short of considering the division of tax revenues between the federal and provincial governments. This is a political decision, and the Tax Structure Committee of Ministers has been established to make recommendations about this question.

3. Our third and final assumption relates to the expenditure side of the fiscal system. To restrict our Report completely to an analysis of the revenue-raising side would be equivalent to saying that we think it meaningful to ignore one blade of a pair of scissors. There may be some who would say that our efforts should be directed to spreading more equitably the "burden" of taxation and that we should not concern ourselves with the results of government expenditures. But in many respects one is essential to the other and it is their joint product that must be our concern. Therefore, while we do not attempt to assess government expenditure programmes, we do not ignore them.

THE NATURE OF THE INQUIRY

Like most Royal Commissions in recent years, our inquiry has had two aspects. Briefs were received and public hearings were held across the country in order to elicit the suggestions of all interested parties. In addition, a considerable research programme was instituted.

Appendix A to this Volume provides the names of all companies, organizations and individuals who presented briefs or appeared before us. It is a truly formidable list. We received over 300 briefs, and heard approximately 700 witnesses in 99 days of public hearings in 12 cities across Canada. We made every effort to ensure that no one went unheard.

The vast majority of briefs were unsolicited. In a few instances we asked individuals and organizations if they would be willing to appear before us because we particularly wanted to obtain their views. In every case our requests were met. To a few organizations we sent lists of questions in advance of the hearings so that we could discuss efficiently with the participant the many technical points that were of major interest to us. This made it possible for the hearing to move quickly from the general to the specific points at issue. This technique worked well; and we were able to explore the issues fully. We are confident that we have heard all points of view as to what would constitute a desirable Canadian tax system.

Obviously, no one wants to pay taxes; and almost everyone is prepared to argue that his taxes are too high relative to those paid by others. There is an inevitable and endless conflict of interest among taxpayers that cannot be completely resolved. This is reflected in many of the briefs we received. At our hearings we not only sought to elicit the ideas of the participants but also to explore any conflicts between private and public interests that were implicit in their suggestions. Despite the fact that most participants wanted tax concessions, we found a remarkable willingness among them to consider and appraise frankly the wider implications of their proposals. We hope that, by bringing out at the hearings any conflicts between a participant's suggestions and the public interest, we have performed a useful task. This is a function we continue to pursue in our Report; for we have not only tried to derive a blueprint for the tax system of the future, we have also tried to spell

out the major alternatives put before us and to assess frankly their good and bad points. There are few, if any, obvious "answers". Only in such a way can public discussion and understanding of the real problems of the tax system be fostered.

Our task was so large, and the issues so many and so technical, that we developed an extensive research programme. The purpose of the research programme was twofold:

1. To provide technical evaluations of the proposals submitted in the briefs.

2. To prepare objective studies of some of the larger, basic questions that those appearing before us could not be expected to cover.

Because of the scarcity of information and the costs of collecting new data, many participants were forced to rely on impressions and experience to support their proposals and suggestions. Our research programme was designed to canvass thoroughly all of the available, relevant information and, in so far as time and resources permitted, to put together new material. We have tried to test ideas against the facts. While we have not been able to go as far as we would have liked, we believe that our Report, which draws heavily on these studies in some areas, will throw new light on some of the questions that have been discussed in recent years and, we hope, will stimulate further empirical work in the tax field.

In our Report we have tried, wherever possible, to give the reasoning behind our recommendations and we have sought to make our recommendations as specific as we could. Moreover, because of the magnitude and complexity of the task, we have sought, where it seemed necessary, to spell out priorities among our recommendations in the hope that the government of the day would move in a gradual and orderly fashion from where we now are to where we think we should be.

The Honourable Mitchell Sharp, Minister of Finance. brought down a Supplementary Budget on December 19. 1966. This Budget announced increases in the manufacturer's sales tax and in the old age security tax. The Minister stated that the proposed tax changes would raise slightly less than $300 million in additional revenue in 1967.

We have not taken the announced tax changes into account in our Report. Many of the chapters that would have required revision had been printed prior to December 19. This means that in all of the discussion of the Report where the present system is compared with the proposed system, the present system refers to the tax system prior to the December 19 changes. However, it should be noted that the system we propose would raise more revenue than the present system prior to the December 19, 1966 Budget changes, and about the same revenue as would be raised under the present system after the announced increase in rate.

INTRODUCTION

The Commission was required to make the widest possible inquiry into the Canadian tax system. We have investigated a multitude of complaints. The tax systems of other countries have been studied to determine whether better provisions and methods have been adopted elsewhere. The briefs submitted and the technical literature have been searched for ideas. New and existing data have been compiled and analyzed to assess the burden of taxes in Canada and the effects of the existing system on the economy. On the basis of all of this information, the Commission has reached the following conclusions:

1. The present system does not afford fair treatment for all Canadians. People in essentially similar circumstances do not bear the same taxes. People in essentially different circumstances do not bear appropriately different tax burdens.

2. Canadians are less well off than they could be because there are fewer goods and services available than could be provided with the more efficient use of labour, capital and natural resources. The present tax system has contributed to this unfortunate result in two ways:

   a) It needlessly distorts the distribution of productive goods and services.

   b) It fails to compensate where it could for some non-tax barriers to the efficient allocation of productive goods and services.

3. The fiscal system has not been used as effectively as it could have been used to maintain full employment, contain inflationary increases in the price level, and encourage Canadian ownership and control of Canadian industry.

4. In some tax fields compliance and collection costs have been needlessly raised because of duplicate federal and provincial administrations.

5. Federal tax administration is not sufficiently shielded from political influence and is too centralized for efficiency and convenience.

6. Federal procedures used to obtain and analyze new ideas prior to the introduction of new federal tax legislation are inadequate, as are the procedures for hearing the views of taxpayers and other interested parties on proposed legislation.

7. Federal administrative and judicial appeal procedures are deficient and require reforms.

We are fully aware that these conclusions constitute a severe criticism of the present tax system. They were not arrived at lightly nor are they the inevitable result of preconceived opinions. Our bias when we began our task was that the present system was basically sound and compared favourably with the systems of other countries. While we are still of the opinion that the present Canadian tax system is as good as most other systems, we are convinced that it falls far short of the attainable objectives. We therefore recommend many fundamental changes which, if adopted, would produce a complete transformation and, we believe, result in greater equity and efficiency.

We hope Canadians will accept the challenge implicit in our recommendations. And there can be no doubt that our recommendations constitute a great challenge. Preconceived opinions about taxation are deeply and firmly held. Many will find it extremely difficult to take a new look at old questions. Because some facts cannot be readily ascertained, honest differences of opinion are inevitable. There is a danger that the debate about these minor factual questions will divert attention from the major issues.

Great damage could be done by the espousal of all the popular measures recommended and rejection of the others—without appreciating that the politically attractive changes are only feasible as part of

an integrated programme. These and many other hurdles have to be overcome if Canada is going to obtain the best possible tax system.

The purpose of this Introduction is to set forth the high lights of our Report as simply as we can so that the reader will know where we stand on the basic issues. This chapter therefore constitutes a brief summary of the main features of the Report. Because our conclusions with respect to tax administration are self-explanatory, we say no more about them here.

OBJECTIVES

A tax system can be judged from different points of view. Is the system fair? Does it contribute as much as possible to the growth and stability of the economy? Are the rights and liberties of the individual protected? Does it help to strengthen the federation? These questions reflect not only the many facets of taxation but also what we believe to be the principal objectives that Canadians wish to realize through their tax system. They want equity, more goods and services, full employment without inflation, a free society and a strong, independent federation.

Evaluating an existing tax system or designing a new tax system is complicated because we seek to realize all of these objectives simultaneously and they are frequently in conflict. In trying to achieve one objective more fully, another is less adequately realized. For example, adopting a particular tax provision might increase the rate of economic growth. However, the same provision might also reduce the fairness of the system by providing some group of individuals with a tax advantage relative to others in the same circumstances. Similarly, making a tax system more equitable may necessitate increased complexity in the tax law. This greater complexity may mean that fewer individuals know and understand the law so that individual rights and liberties are jeopardized.

Sometimes these kinds of conflict can be avoided. Frequently, other methods can be found to achieve an objective that do not have the unwanted

negative effects on other objectives. The negative effects of an otherwise desirable tax provision on an objective can often be compensated for by introducing or changing other tax provisions. Obviously every effort must be made to avoid spurious conflicts.

But some conflicts among objectives are unavoidable and compromises are inescapable. The "best" compromise depends upon two things: estimates of the extent to which one objective will be sacrificed if another is to be realized more completely; and the relative importance attached to the competing objectives.

When faced with these hard choices we have consistently given the greatest weight to the equity objective. Taxation is one method of transferring command over goods and services from individuals and families to the state. If equity were not of vital concern taxes would be unnecessary. The state could simply commandeer what it needed. The burden of a reduced private command over goods and services would then be borne by those individuals and families who happened to be within easy reach of the state.

The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families. Unless the allocation of the burden is generally accepted as fair, the social and political fabric of a country is weakened and can be destroyed. History has many examples of the severe consequences of unfair taxation. Should the burden be thought to be shared inequitably, taxpayers will seek means to evade their taxes. When honesty is dismissed as stupidity, self-assessment by taxpayers would be impossible and the cost of enforcement high. We are convinced that scrupulous fairness in taxation must override all other objectives where there is a conflict among objectives.

EQUITY PRINCIPLES

Equity has two dimensions. Horizontal equity requires that individuals and families in similar circumstances bear the same taxes. Vertical equity

requires that those in different circumstances bear appropriately different taxes. Two questions, therefore, have to be answered. What personal circumstances should be recognized in allocating tax burdens among individuals and families? By how much should tax burdens differ between those in one circumstance relative to those in another? These are both questions of belief rather than of fact. We can do no more than recommend what we believe to be fair.

We believe that horizontal equity is achieved when individuals and families with the same gains in discretionary economic power pay the same amount of tax. By economic power we mean the power to command goods and services for personal use. By discretionary economic power we mean the residual power to command goods and services for personal use after providing the "necessities" of life and after meeting family obligations and responsibilities. To be more concrete, some part of each family's income must be spent to provide food, clothing, medical expenses and other "necessities". The change in the discretionary economic power of the family is the income the family has available to spend or save after meeting these non-discretionary expenses.

We believe that vertical equity is achieved when individuals and families pay taxes that are a constant proportion of their discretionary economic power.

Both horizontal and vertical equity would be achieved by the adoption of a tax system that embodied the following principles:

1. The family and the unattached individual should be recognized as the basic tax-paying units in the system. The family unit would consist of parents and their dependent children. Transactions and transfers between members of a family unit would have no tax consequences.

2. All resident individuals and families should be taxed on a base that measures the value of the annual net gain or loss in the unit's power, whether exercised or not, to consume goods and services. Such a base would ignore the form of the gain or what was done to obtain the gain. We call this the comprehensive tax base. We also refer to it as "income" because this term is so commonly used. Income to us has, however, a much broader meaning than that ascribed to it under current law.

3. This comprehensive tax base should be subject to progressive rates of tax. The progressive rates would reflect the diminishing relative importance of non-discretionary expenditures for those with larger gains in economic power.

4. The tax burdens of those with particularly heavy family and other obligations and responsibilities should be reduced to reflect the non-discretionary expenditures required to meet them. This would be done through the adoption of separate rate schedules, tax credits and deductions.

Combined with a government expenditure system that provides relatively greater benefits for the poor than for the wealthy, a tax system with these characteristics would redistribute some of the power to consume goods and services in favour of the lowest income groups. We are firmly convinced that this redistribution is necessary if we are to achieve greater equality of opportunity for all Canadians and make it possible for those with little economic power to attain a decent standard of living. However, we are also convinced that the rates of tax which are applicable at any level of income should not be so high as to discourage initiative and thereby reduce the production of goods and services for Canadians.

SIGNIFICANCE OF EQUITY PRINCIPLES

Adoption of these equity principles is of profound significance for this _Report_. Some of the more important considerations are discussed below.

The Taxation of People Versus the Taxation of Organizations

All taxes are ultimately borne by people through the reduction in their command over goods and services for personal use. Taxes can, of course, be collected not only from people but also from corporations, trusts and co-operatives. But organizations as such cannot bear taxes. It is the people who work for, sell to, buy from, or are members, beneficiaries or owners of these legal entities who are made better off or worse off by taxes. It is the effect of taxes on the well-being of people that matters.

Taxes on the Income of Organizations

If it were possible to determine each year the change in the value of each individual's claims against all organizations, and if all those who had claims against Canadian organizations were residents, and if avoidance and evasion were not problems, Canadian organizations should not be subject to income taxes. The shareholder (to consider only one kind of claim against one kind of organization) should bring into his tax base the dividends received from corporations during the year and the gain he made or could have made during the year by selling all of his shares. These two things together constitute the change in the shareholder's economic power from the ownership of shares.

Unfortunately, the foregoing conditions cannot be met. We must continue to collect income taxes from organizations, for reasons that are discussed later. But in so far as the income of these organizations accrues to the benefit of Canadian resident individuals, these taxes on organizations should be considered as withholding taxes collected on behalf of the individuals. Residents should be given full credit for income taxes collected from Canadian corporations, co-operatives and trusts. We have called the provision of a full credit to residents for the underlying corporation tax, the integration of corporation and personal income taxes. Under our proposal the present 20 per cent dividend tax credit would be withdrawn. The integrated

system we recommend would provide for the grossing-up of a dividend (in cash or stock) received by a resident shareholder to its pre-tax amount. That grossed-up amount would be included in income. The shareholder would then be permitted a full deduction from the tax otherwise payable of an amount equal to the corporation income tax attributable to the dividend. Where the credit exceeded the amount of tax otherwise payable the taxpayer would receive a refund.

The integration proposal would be limited to resident shareholders in respect of dividends received from Canadian companies. A partial credit would be allowed for foreign taxes on dividends from direct investment in foreign companies.

Sales Taxes

Rigid adherence to our equity principles would call for the complete abolition of all sales taxes. Any adverse effects which the abolition of sales taxes and the increased reliance on personal income taxes would have on the rate of saving and on Canada's international competitive position could be offset by changes in monetary and trade policies and the fairness of the system would be improved. We do not advocate such a course, in part because we think that virtually the same result could be achieved in a way that would be less disruptive. For reasons to be explained later, we recommend that the federal government abandon its manufacturer's sales tax and replace it with an indirect retail sales tax collected, if possible, by the provinces. Having taken this step the federal government should then seek to provide the provinces with sales tax room in exchange for provincial withdrawal from the imposition of corporation income taxes. This exchange would be ruled out if the federal government left the sales tax field unilaterally.

At some point in the future when virtually all Canadian individuals and families are submitting income tax returns, and suitable means of protecting the revenue have been devised, residents could be provided, in

lieu of sales tax exemptions, with arbitrary credits against their personal income tax liabilities for a portion of the sales taxes paid. However, adoption of the sales tax rate and base that we propose would ensure that sales taxes would not be regressive. We therefore do not consider the adoption of sales tax credits to be urgent.

However, we would like to see a gradual reduction in the relative importance of sales taxes in the Canadian tax mix as a method of increasing the progressiveness of the tax system. This should not be difficult to achieve. As the economy grows, the revenues from income taxes increase more rapidly than those from sales taxes. Thus, if sales tax rates were held at present levels and income tax rates were maintained, the result we seek would be achieved.

We recommend an immediate, although small, reduction in the relative weight of sales taxes by proposing that initially the federal government should impose tax at a 7 per cent rate on the new retail sales tax base. This rate, when applied to the proposed base, which would include some services, together with the elimination of some of the special excise taxes on so-called "luxury" goods, would reduce federal sales and excise tax revenues by about 8 per cent.

THE COMPREHENSIVE TAX BASE

We are completely persuaded that taxes should be allocated according to the changes in the economic power of individuals and families. If a man obtains increased command over goods and services for his personal satisfaction we do not believe it matters, from the point of view of taxation, whether he earned it through working, gained it through operating a business, received it because he held property, made it by selling property or was given it by a relative. Nor do we believe it matters whether the increased command over goods and services was in cash or in kind. Nor do we believe it matters whether the increase in economic power

was expected or unexpected, whether it was a unique or recurrent event, whether the man suffered to get the increase in economic power or it fell in his lap without effort.

All of these considerations should be ignored either because they are impossible to determine objectively in practice or because they are irrelevant in principle, or both. By adopting a base that measures changes in the power, whether exercised or not, to consume goods and services we obtain certainty, consistency and equity.

For the vast majority, adoption of the comprehensive base would not result in great changes. Most employees, for example, are now taxed on a comprehensive tax base. To the few, particularly property holders, it would involve a great broadening of the tax base.

A large part of our Report is devoted to the development of specific recommendations that would implement the comprehensive tax base. But before describing the major features of the comprehensive tax base for particular kinds of gains we should indicate why we have rejected consumption and wealth as tax bases.

Consumption and Wealth as Tax Bases

To tax consumption expenditures rather than income would be to exempt saving. To tax wealth rather than income would be to exempt consumption. With one exception we see no merit in exempting either saving or consumption. Because most individuals and families spend everything they earn during their lives, to change from a system that taxed what was spent rather than what was earned would simply change the time pattern of taxes throughout life. Taxing consumption rather than income would increase taxes for the young and the old, since youth and old age are the periods when consumption is high relative to income. It would reduce taxes in middle age when saving is typically at its peak. We do not think this would be an improvement.

Taxing wealth rather than consumption would obviously put those who obtain their income from their human capital (e.g., intelligence, knowledge, strength and skill) at an advantage relative to those who obtain their economic power from the ownership of property. It would penalize those who save relative to those who consume. We do not believe that property holders should be able to escape, as they do at present, paying taxes on much of the economic power they derive from their property. But we also do not believe that they should bear a heavier tax burden than those who obtain the same economic power from human capital. It is what you get, not how you get it, that should count for tax purposes.

We would, however, make one important exception. Through the special deductions now available for contributions to retirement savings, individuals are encouraged to save for retirement. This is a worthwhile social objective that the tax system can help to achieve. We therefore recommend that within limits retirement contributions should continue to be deductible.

Adoption of a tax system with retirement savings deductible without limit would convert an income tax system into a modified consumption expenditure tax system. That far we are not prepared to go. We propose stringent limits on the amounts that could be deducted in computing income. These limits would be related to the pension that could be obtained at age 65 rather than to an amount that could be deducted in a given year. This, we believe, would put an end to the abuses of the present provisions by a few upper income individuals, and yet would permit flexibility in the timing of contributions.

Under our proposals the tax treatment of the earnings of pension funds would be liberalized, and there would be great flexibility in the investment of pension funds, so that retirement savings would become more attractive than they are now. The limits we suggest are sufficiently high that low and middle income individuals and families would be free to choose to be taxed on an income basis or an expenditure basis depending upon how much they wished to save for retirement.

Employment Income

Adoption of the comprehensive tax base would have less effect on the taxation of employment income than on most other kinds of income. However, some benefits in kind are now escaping tax, and strong measures should be taken to stop this abuse. On the other side, the failure to allow the deduction of expenses of earning employment income should be corrected.

Relative to other kinds of taxpayers many employees have been overtaxed. Tax has been withheld at source and the deduction of virtually all the expenses of earning that income has been denied. Drawing the line between the expenses of earning income and personal living expenses is exceedingly difficult, but we think that the present treatment has been too severe for many employees and often too generous for the self-employed.

The prohibition against the deduction of the expenses of earning employment income should be withdrawn and employees should be entitled to deduct the expenses reasonably related to earning income, as are proprietors and partners. To reduce the administrative problem to manageable proportions, employees should be entitled to deduct the greater of an arbitrary proportion of their employment income or their actual expenses.

The administration has not been sufficiently stringent in bringing employee benefits in kind into tax. Faced with high taxes on money income on the one hand, and the possibility of no tax on non-cash benefits on the other, employers and employees have found it attractive to substitute the one for the other. Free or subsidized meals, trips, homes, discounts, insurance policies and so on, are being accepted as remuneration to the mutual benefit of the employer and employee and to the detriment of the revenue and of other employees whose taxes are correspondingly higher. To stop this trend we recommend that employers should either add the value of all non-cash benefits to the tax base of the employee or pay a high tax on the amount not allocated to employees.

The "expense account living" problem may not be of great significance from a revenue point of view. The amounts involved in aggregate are probably not great. But the suspicion that some are enjoying exotic holidays, lavish food and drink and expensive entertainment out of untaxed income is demoralizing even if frequently ill-founded.

Seeking out new tax dodges becomes a game; boasting about "getting away" with an outrageous abuse, a pleasure; hearing of the opportunities missed, a torment. To stop "expense account living" we propose some arbitrary rules that undoubtedly will be castigated as unreasonable. We frankly admit that some of them are stringent. That is exactly what we intend. The problem of taxpayer morale is serious and the strongest measures are called for. We deny that the rules we propose are unreasonable, however, relative to the alternatives. This is an area where generalities are useless and specific—if arbitrary—rules are the only solution.

Property Income

The decision to tax the annual changes in the economic power of each tax unit rather than "income", as it is now defined, has dramatic consequences.

For adoption of the comprehensive tax base requires the taxation of not only income from property, but also "capital" gains on the disposition of property. Almost everyone is familiar, at least in a general way, with the difference between "income" and "capital", even though the words seem to be incapable of precise definition. Capital is the source of income. By levying a tax on "income" the distinction between the two concepts takes on great significance, for if the courts find a particular gain to be "capital" the transaction is not now taxable. There is an enormous incentive for the taxpayer to try to transform "income" gains into "capital" gains. However, it is impossible to draw an unambiguous distinction between "capital" gains and "income" gains and the attempt to

do so necessarily results in great uncertainty for the taxpayer because a particular transaction may or may not be found by the courts to fall on one side of the line or the other.

After the most careful and exhaustive consideration of this complex question, we have arrived at the conclusion that the present distinction between kinds of gain is inconsistent with our concept of what we believe "income" is for purposes of determining the individual's capacity to pay tax.

A dollar gained through the sale of a share, bond or piece of real property bestows exactly the same economic power as a dollar gained through employment or operating a business. The equity principles we hold dictate that both should be taxed in exactly the same way. To tax the gain on the disposal of property more lightly than other kinds of gains or not at all would be grossly unfair.

These radical reforms are advocated because equity can be achieved in no other way, because in our opinion there would be no adverse economic effects through their adoption when combined with our other proposed changes, and because they would simplify the tax system and reduce uncertainty.

If the full taxation of property gains would result in dire economic consequences or hopelessly complex administrative questions, some backing away from equity principles could be justified. We are satisfied that neither result would come about.

Accordingly, we recommend the full taxation of realized property gains. To prevent unwarranted postponement, to minimize the "locking-in" effect, and to stop residents from avoiding the tax altogether by leaving the country, property gains should be deemed to have been realized on the death of the owner (unless the property passes to a surviving spouse or other member of the family unit) or on his leaving the country. For administrative

reasons we recommend a lifetime exemption of $25,000 on realized real property gains on residences and farms.

Simply to adopt the full taxation of capital gains as a modification of the present system could be disastrous, as critics of the taxation of these gains assert. This is not what we are recommending. The effects of taxing capital gains in full can only be assessed as one feature of an entirely new system. The new system would have:

1. Much reduced marginal personal rates of tax.
2. Averaging provisions of unparalleled liberality.
3. Loss provisions that would remove any tax bias against risk taking.
4. Full credit to residents for Canadian corporation taxes.
5. More efficient incentives for new and small businesses.

When the taxation of capital gains is only one component of a package with these features, we can dismiss the claims that it would destroy initiative, reduce saving, and drive people out of the country.

We have no intention that the taxation of property gains should be retroactive. Accordingly, we propose that only gains accruing after the effective date of the legislation should be subject to taxation, with a liberal option to avoid the necessity of a multitude of valuations.

The charge that to tax capital gains would raise no revenue and create great complexity can also be readily disproved. Even with the taxation of capital gains at half rates, and no deemed realization on death, the taxation of capital gains in the United States provides a significant proportion of federal revenues. However, we wish to emphasize that, even if our proposals for taking capital gains and losses into account in computing income produced no revenue, we would nevertheless recommend that they be taken into account for the reasons that we have outlined. Administrative complexity would actually be reduced by the full taxation of capital gains, as it is the attempt to distinguish between capital and income gains, in order to tax the one at a different rate than the other, that creates the complexity and uncertainty.

Business Income

We will not attempt to describe in detail the many changes we propose in the measurement of business income for tax purposes. They are, by their nature, highly technical. The most important are:

1. Elimination of the problem of "nothings" (business expenses that cannot be deducted for tax purposes at any time).

2. Elimination of many arbitrary rules, and hence greater reliance on accounting practices, in the tax treatment of reserves.

3. Recognition of the last-in-first-out method as an acceptable method of inventory accounting under restricted conditions.

4. Adoption of less stringent limitations on the deduction, carry-forward and carry-back of business losses.

5. Provision of more stringent limitations on losses created by the deduction of personal expenses.

6. Introduction of a system of rapid write-offs of capital expenses as an incentive for new and small businesses. This incentive would be more efficient, and less open to abuse, than the low rate of corporation tax on the first $35,000 of corporate income. The low corporate rate should be withdrawn.

Gifts, Inheritances and Windfall Gains

Consistent with the principle that all increases in economic power should be taxed without regard to kind or source, all gifts, inheritances, and windfall gains should be brought into the tax base. We would, however, ignore gifts, including inheritances, between members of a family unit (as defined below). Lifetime and annual exemptions for gifts received from outside the family would be provided to reduce the administrative problem to manageable proportions. These exemptions would mean that most people

would never pay tax on any gifts. The proposed system would be much more effective than the present gift tax in bringing large gifts into the tax net. The present tax is often avoided.

Non-charitable gifts should not be deducted from the tax base of those who make them. Making a gift is an exercise of economic power and should be treated in the same way as any other personal expenditure. Gifts to charity should, however, be deducted from the tax base, subject to certain conditions and limitations.

Government Transfer Payments

The comprehensive tax base calls for the inclusion of all kinds of gains. We would not exempt from this rule government transfer payments, such as family allowances, old age security payments, unemployment insurance benefits and workmen's compensation payments. We would, however, allow the deduction of specific contributions to these transfer programmes. In recommending that these government transfer payments be brought into the tax base we do not prejudge the adequacy of the payments made under such programmes. The amounts of the benefits and contributions should be reviewed in the light of our recommendations. But we are convinced that the consistent application of the rule we suggest would remove many of the anomalies that now exist; for example, a man who works part of the year and obtains unemployment insurance part of the year may pay less tax than another man who receives the same income and works all of the year.

FAMILIES AND INDIVIDUALS AS TAX UNITS

The present system recognizes only the individual and not the family as a unit for tax purposes. This has certain undesirable consequences. A couple with one income recipient often pays substantially more tax than another couple with the same aggregate income derived by both spouses. If a man with a substantial salary marries a woman with a substantial independent income, their aggregate tax is not changed by their marriage.

Yet it is clear that their discretionary economic power is greater because of economies which can be realized by living together.

Because income splitting results in important and unwarranted tax savings, married business proprietors would find it advantageous to hire their wives at high salaries to perform nominal duties if this were not prohibited. The prohibition results in anomalies. If the proprietor's wife does in fact perform productive work for the business the proprietor and his wife would be better off, from a tax point of view, if the wife worked elsewhere and the proprietor hired another person to do the same work. The man who owns and manages an incorporated business can often circumvent the prohibitions by having "the corporation" hire his wife.

We therefore recommend in this Report that the income of families should be aggregated and taxed as a unit on a separate rate schedule. The rules against income splitting could largely be withdrawn because splitting would have no significance.

The most serious consequence of the failure to accept the family as a taxable unit arises when wealth is transferred from one spouse to another. Although in most families wealth accumulated by a couple is the result of their joint efforts and decisions, the passing of property from one spouse to another is a taxable event. Exemptions provide some relief, but we believe that the taxation of these intra-family transfers is wrong in principle. On the other hand, we have expressed our belief that all increases in the economic power of the taxpayer, regardless of their source, provide the same increase in tax-paying capacity. Thus, all gifts or bequests received from outside the family unit should be included in the comprehensive tax base.

We are of the opinion that the present system of gift and death taxes, both federal and provincial, is an anachronism. Through the use of personal corporations, trusts and exemptions, it is possible to avoid and

postpone substantial gift and death taxes. These taxes almost certainly are not effective in breaking up pockets of wealth held by family dynasties, as is sometimes believed. They can, however, make it extremely difficult for a man to maintain his widow in the style she enjoyed when he was alive by substantially reducing the amount of property left for her support, even though he could not have accumulated the property without his wife's help.

We recommend an entirely different system. The present gift and death taxes should be withdrawn and transfers of wealth within family units should have no tax consequences. Transfers of wealth from one family unit to another tax unit should be taxed at full progressive rates to the recipient tax unit, subject to small annual exemptions and a $5,000 lifetime exemption. Transfers of wealth between husbands and wives and between parents and minor children would not therefore come within the purview of the tax system at all. However, when children leave home, all property taken from the family, with certain exemptions for administrative convenience, would be taxable to the child. Any subsequent transfers from the family to the grown-up son or daughter, or to anyone else for that matter, should be taxed to the recipient. The family would ordinarily cease to exist on the death of the last surviving spouse. Property passing to other individuals or families on the termination of the family unit would also be taxable to the recipients.

PROGRESSIVE RATES OF TAX

Should taxation be progressive or proportionate? This is one of the most contentious issues in taxation. Our answer is clear and unequivocal. The tax base of each family and unattached individual should be subject to progressive rates of tax. Because we believe that non-discretionary expenses absorb a much larger proportion of the annual additions to the economic power of those with low income than of the wealthy, in order to attain the proportionate taxation of discretionary economic power, we

recommend that a base that measures total economic power be taxed at progressive rates.

It is not possible to measure accurately the proportion of a family's income that is required to meet non-discretionary expenses. What constitutes a "necessity" and what constitutes a "luxury" is essentially subjective. The wealthy man's necessities are the poor man's luxuries; with a rising income what was once a luxury becomes a necessity. A progressive rate structure that attempts to reflect the diminishing relative importance of non-discretionary expenses as income rises can only reflect a judgment of what is fair and reasonable.

The personal income tax schedules we recommend do have one anchor point, however. The rate schedules have a top marginal rate of 50 per cent. We think there is psychological merit in a rate structure that would limit the state's claim against a man's additional income to one half. In our opinion, it is essential that the marginal rates of tax be kept low enough that the incentive to produce goods and perform services and invest funds is not destroyed.

There is also a more concrete reason for advocating this top rate of 50 per cent. A substantial part of the net economic benefit that Canada secures from foreign direct investment in Canada is the revenue derived from levying income and withholding taxes on non-resident-controlled Canadian corporations. To push the present rate of tax on corporations higher would deter foreign investment; to reduce the rate would transfer revenue from the Canadian treasury to foreign treasuries. The 50 per cent corporate rate, therefore, should not be changed.

As already indicated, we propose that resident shareholders should receive full credit for corporation taxes. With a corporate rate of 50 per cent, if personal marginal rates of more than 50 per cent were adopted, upper income individuals could postpone their taxes by retaining profits

in the corporations they controlled. It is essential to recognize that the postponement of taxes is equivalent to the reduction of taxes; indefinite postponement is equivalent to the elimination of a tax. The possibility of postponement biases corporation decision making, puts great pressure on taxpayers to discover means of realizing the retained earnings at less than the full rate of personal tax, and provides upper income shareholders with an advantage relative to upper income individuals who obtain their income in other ways, for example, by working for a salary. These serious problems can be eliminated by adopting a top marginal rate of tax that is not significantly higher than the corporate rate of 50 per cent.

The top marginal rate is now about 80 per cent, and applies to income in excess of $400,000. In our opinion, rates as high as this are on the statute books only because they are readily avoided by most of the few wealthy people with incomes of this size. By transforming income into non-taxable forms and through a myriad of tax avoidance techniques, the 80 per cent rate can be effectively circumvented, so that the effective marginal rate is much lower. Indeed, the effective average rate of tax on all income, including property gains, is now probably no more for extremely wealthy people than it is for those with much lower incomes.

We have examined the weight of total taxes on groups of families and individuals with different incomes as well as the value of the government benefits they receive, and find that while most middle and upper income taxpayers are net contributors to government, many of those at the very top are not making net contributions that are sufficiently large relative to their discretionary economic power. Broadening the base as we recommend, and lowering the rates as we propose, would increase the weight of tax on many wealthy families and individuals because the lower marginal rates would be more than offset by the broader base.

The present tax system, combined with the present system of government expenditures, particularly the system of transfer payments, such as

family allowances, old age pensions and unemployment insurance, redistributes goods and services in favour of those at the bottom of the income scale. This is as it should be. However, the present system of transfer payments has important gaps. While the indigent as a group are net beneficiaries of government, some unfortunate families and individuals who do not benefit materially from government programmes are net contributors to government rather than net beneficiaries. This inequity can be removed either by reforming the system of government transfer payments to fill the gaps or by reducing personal income tax liabilities for those who are wholly or partially dependent upon gifts or allowances for subsistence. Pending a review of the former matter, which is quite outside our terms of reference, we believe that most low income families should pay lower taxes. As we show later, we believe that the adoption of our recommendations would have this result.

SPECIFIC NON-DISCRETIONARY EXPENDITURES

Through the progressive rate structure it is possible to reflect the reduced relative importance of non-discretionary expenses generally as income rises. There are, however, specific non-discretionary expenditures that should also be taken into account if equity is to be achieved.

We have already said that the system should recognize both families and unattached individuals as taxable units. This raises the question of the appropriate relationship between the taxes imposed on families and unattached individuals; on families with children relative to those with no children; and on families with one child relative to those with, say, ten children.

In our opinion a childless couple should pay lower taxes than an unattached individual with the same income. This difference would reflect the fact that two cannot live as cheaply as one. But when two people with

incomes marry, and both continue to receive these incomes, their total tax should increase, because there are economies in living together. These tax differentials can be obtained by adopting two separate rate schedules: one to be applied to aggregate family income and another to be applied to the income of unattached individuals.

With separate rate schedules the present system of personal exemptions for the taxpayer and his or her spouse can be eliminated. The same result can be achieved in a simpler way by the use of a first income bracket taxed at a zero rate. This is what has been done in the proposed rate schedules. The significance of such a change is to bring closer together income and taxable income. Taken by itself it has no impact on the calculation of an individual's taxes.

The present system takes into account the non-discretionary expenses of raising children by providing parents with an exemption for each child. The size of the exemption is affected by the eligibility of the child for family allowances. This approach has two weaknesses. First, it does not recognize that the first child involves greater non-discretionary expenditures than subsequent children. The parents often must find different and more expensive accommodation, equipment must be bought and, most important of all, the mother must either stop working or hire someone to look after the child. Subsequent children involve additional costs, but they are not as great as for the first child. The second weakness is that the present exemptions for dependants provide a greater benefit to those with larger incomes.

These faults can be overcome by the use of tax credits for children, with a larger credit for the first child than for the others. This we have recommended.

Most medical expenses are clearly non-discretionary expenses. Taxes, therefore, should be lowered for those who have unusually heavy expenses

of this type. The 3 per cent of income floor should be retained as a rough-and-ready dividing line between the exceptional and the "ordinary" medical expense. Only out-of-pocket expenses in excess of this floor should be deducted and not, as at present, amounts reimbursed through insurance. The standard deduction for medical expenses should be withdrawn.

Working mothers with young children are faced with substantial non-discretionary expenses. A tax credit should be provided to taxpayers in this situation.

The present deductions for the costs of post-secondary education should be abandoned and a system of transferable credits adopted that would be of greater value to low income parents and students. Living costs of students taking such education should also be recognized.

The administrative procedure for granting deductions for charitable donations should be revised to protect the treasury.

DISTORTING EFFECTS OF THE TAX SYSTEM

The narrow tax base and some extremely expensive incentive or concessionary provisions built into the present system mean that, to raise the required revenue, tax rates have to be higher than would otherwise be necessary, and the tax burden on some is therefore correspondingly heavier. This has the effect of driving labour and capital away from activities that are heavily taxed and drawing them into tax-favoured activities. Unless these pressures nicely compensate for non-tax distortions in the market, labour and capital are less productively employed than they should be. Fewer goods and services are available for Canadians. Some features of the tax system that unduly narrow the base have already been described. Other incentive or concessionary provisions that have a high revenue cost are:

1. The low rate of corporation tax on the initial $35,000 of taxable income.

2. The depletion allowances for the mining and petroleum industries.

3. The three-year exemption for new mines.

4. Inadequate taxation of the business income of life insurance companies.

All of these concessions should be withdrawn. More effective incentives could be provided at much lower revenue cost. The extra revenues could be used to reduce rates on business income generally.

The present system also has a number of specific biases that can only have a detrimental effect on the allocation of labour and capital. Among the most important are those listed below:

1. The stringent treatment of business losses makes investment in risky enterprises less attractive because the government shares in the gains while the investor may have to bear all of the losses.

2. Inadequate averaging provisions make activities that produce "bunched" income less attractive.

3. Inconsistent tax treatment of various forms of business organization (partnerships, proprietorships, corporations, trusts and co-operatives) penalizes somes activities that are unable to adopt the most advantageous form of organization. This bias arises largely because of the so-called "double" taxation of corporate source income.

4. Retained earnings of corporations are given a tax advantage and high rates of distribution are penalized by the "double" tax on dividends and the failure to tax share gains. Tax considerations thus distort the pay-out policy of corporations.

5. Purchases of Canadian equities by Canadian financial institutions are discouraged because these institutions do not benefit from the dividend tax credit.

All of these biases can and should be removed.

THE USE OF THE TAX SYSTEM TO COMPENSATE FOR MARKET DISTORTIONS

At least in the present state of our knowledge the market usually provides the best mechanism for allocating productive facilities and services so that people obtain the largest output of the goods and services they want. We are anxious that the tax system interfere as little as possible with this allocation. However, the market does not work perfectly and can distort the allocation of the means of production just as the tax system can. In particular, we believe that the capital market is biased against new, small risky enterprises. The tax system can be used to offset that bias and we propose some incentives for that purpose. In addition to the full credit to resident shareholders for corporation taxes, there should be:

1. A more liberal treatment of losses, including the full write-off against all other income of any losses in the initial years of a new business.

2. An immediate write-off of capital costs for new businesses up to a specified limit.

3. Continuation of the immediate write-off of exploration and development expenses for mining and oil companies.

4. Continuation of the exemption from taxation of the income of qualified retirement savings funds (including capital gains) until it is distributed to individuals.

5. Continuation of the immediate write-off of research and development expenditures, possibly complemented by subsidies.

6. Tax credits for post-secondary education and training.

Together these incentives would provide a substantial inducement to greater technical progress, risk taking and initiative.

INTEGRATION OF PERSONAL AND CORPORATION INCOME TAXES

As stated earlier, we believe that resident shareholders should be given full credit for Canadian corporation taxes. We believe this to be in the interest of Canadian consumers.

It is frequently argued that shareholders should not be given credit for underlying corporation taxes because corporations pass such taxes on, typically by charging higher prices for what they sell, sometimes by paying less for what they buy. We accept that this is often true, but do not think it is a valid objection to the full credit to shareholders.

Corporation taxes are "passed on" in two ways: through immediate increases in prices or reductions in costs that quickly restore the after-tax rate of return to corporate assets; through gradual increases in product prices (relative to what they otherwise would be) resulting from reduced capital spending and hence output. In the former case the corporation tax is a crude and regressive sales tax. In the latter case the corporation tax is a crude and inequitable tax on wealth, because the tax is borne by those who happen to hold the "wrong" shares at the time the tax is imposed. These shareholders bear the tax because it is capitalized in lower share prices.

Consumers are worse off in either case. Either their real purchasing power is reduced because prices are higher or wages are lower or there are fewer goods and services available.

The important issue is, of course, what would happen if full credit was allowed for corporation taxes now. Here again there are two possibilities. The tax reduction on corporate source income could be quickly passed on to consumers through lower prices or passed on to workers through higher wages. The tax reduction could be capitalized in higher share prices. Only when the corporation was completely insulated from the competition provided by the entry of new firms attracted by the higher after-tax rate of return to shareholders would the full amount of the tax reduction likely be capitalized in

the price of the shares. Few corporations have such a monopoly position. Probably the rise in share prices would be relatively small. If the tax reduction was not shifted quickly through lower prices, the higher after-tax rate of return to shareholders would stimulate capital spending, increased output and lower product prices and hence push down after-tax rates of return toward earlier levels. This process of adjustment would take a substantial period of time.

Consumers would benefit from the corporation tax credit if the tax reduction was passed on in lower prices or brought about increased output or both. Consumers generally would not benefit from the corporation tax credit if the tax reduction was simply reflected in higher share prices without any increase in capital expenditures and output.

We are confident that the instances of full capitalization of the tax reduction without favourable price and output effects would be the exception rather than the rule. To deny the tax reduction because the shareholders of a few corporations would obtain windfall share gains would be to cut off our collective noses to spite our collective faces. We would be denying ourselves greater output from the economy generally to ensure that the few did not get what they did not deserve. There are other methods for dealing with corporations that have massive and persistent monopoly power. To design a tax system to suit the exceptional case would be to lose all perspective.

Another advantage of the integration of corporation and shareholder taxes and the full taxation of property gains would be the prevention of tax avoidance. Under this system profits of all kinds and from all sources would be taxable in the same manner. Accordingly, there would be relatively little incentive to arrange transactions in such a way as to change the form of payment. The basic inconsistencies in our law which have resulted in widespread "surplus-stripping" and other abuses would be eliminated. This result is, in our view, further evidence of the fundamental soundness of the system we propose.

FULL TAXATION OF SHARE GAINS

While we believe that resident shareholders should be given full credit for Canadian corporation taxes, we also believe that share gains should be taxed in full. These proposals should be considered as two sides of the same coin and not as two separate and separable proposals. The integration of personal and corporation income taxes through the full credit device would substantially reduce the weight of tax on Canadian corporate source income for residents; the full taxation of share gains would have the opposite effect. We have satisfied ourselves that, with the rates of personal tax that we propose, the net effect of the two changes would be to reduce the weight of tax on most Canadian corporate source income attributable to residents. Only some shareholders, particularly those holding shares in the extractive industries and life insurance companies and companies in special circumstances, would be worse off.

With lighter taxes on corporate source income the cost of equity capital would be reduced. This would increase capital spending and provide Canadians with more goods and services in the future.

FOREIGN OWNERSHIP AND CONTROL

The integration of personal and corporation income taxes would have another important and valuable side effect. Because full credit for Canadian corporation taxes would be confined to residents, and because Canadians would find holding Canadian shares more attractive than they do now, we expect that Canadian share prices would rise despite the full taxation of share gains. The cost of equity capital in Canada would be reduced. Canadian corporations, including those controlled by non-residents, would be encouraged to offer more shares to Canadians. This would be as effective or more effective an incentive for Canadian ownership than the lower withholding tax that is now in effect for corporations that have the desired degree of Canadian ownership. It would not have the same drawbacks.

The tax system could be used, in conjunction with other policies, to reduce our dependence on foreign capital, but this would result in a reduced growth rate or require reduced current consumption. It is by no means obvious that Canadians would thereby achieve greater economic independence.

THE USE OF THE TAX SYSTEM FOR ECONOMIC STABILIZATION

Canada has not succeeded in maintaining full employment or in containing inflation. Canadians have good reason to be dissatisfied with the past performance of the economy. After 1957 there was an extended period when the expansion of the national product was disappointing in terms of past performance. The level of unemployment was extremely high. While the situation improved markedly after 1963, this must not blind us to the fact that the rise took place from a low level and that the current level of output is below what could have been achieved had unemployment been prevented.

Can the tax system be used to prevent periods of unsatisfactory performance? The following points are relevant in answer to this question.

The tax system is too blunt an instrument to be used as a counter against those relatively momentary checks in the expansion of the economy that occur with fair regularity. By the time the check is recognized, its cause located and changes in the tax law readied and passed, the tax change would be too late to be of use and could well prove to be harmful by overreaching in the opposite direction. Such a statement should not be taken to preclude designing a tax system that reacts instantaneously in a broad and predictable way to such momentary checks. Rather it precludes reliance on discretionary fiscal policy changes to smooth out all short-term fluctuations.

The situation is quite different in respect of those prolonged periods of unsatisfactory performance which have occurred in the past, such as the inflation after 1946, or high unemployment after 1957. In these circumstances the persistence of the movement allows ample time in which to rally

government policy. It is important that, once these persistent movements are detected, policy should not be diverted by the appearance of momentary checks.

There is no single explanation of past policy failures. Mistaken diagnosis of the underlying causes of unemployment certainly played an important part in the late 1950's and early 1960's. Canada was thought to be suffering from structural unemployment and inflation when the basic problem was inadequate demand. Governments delayed and acted timidly because they were concerned about "balancing the budget". In our opinion, the remedy would have been a larger deficit to increase demand, and thereby achieve full employment and higher revenues. There seems to have been inadequate awareness that the fiscal system acts as a brake upon an expanding economy unless the rapidly growing revenues are offset through tax cuts or expenditure increases. Budgets have often been less expansionary or more restrictive than was thought to be the case at the time they were introduced.

Just as there is no single explanation for past failures, there is no single change that would solve all of Canada's problems. There are, however, many specific actions that could be taken to improve future performance. Although a few new instruments for stabilization purposes are available, what is mainly required is a better understanding of when and how to use the existing policy tools and more boldness and steadfastness in pursuing stabilization goals.

Tax changes are not the only instrument for stabilizing the economy. Changes in expenditures and monetary policy are particularly important. However, with a fixed exchange rate and foreign exchange commitments that restrict the use of monetary policy under some circumstances, Canada needs an effective fiscal policy more than ever.

Canadians must become more aware both of the great significance for long-term economic growth of the continued maintenance of full employment

and of the vital role that an effective fiscal policy can play in achieving that objective.

INCREASING THE RATE OF GROWTH

The rate of growth of national income can be increased without cost by avoiding lapses from full employment. It also can be increased by sacrificing leisure for work, and current consumption for future consumption. Although the tax system can be designed to induce more work and less current consumption, it would be foolish to do so until the costless increases are obtained and it is established that the resulting growth rate is still inadequate.

EXAMPLES OF THE EFFECTS OF OUR RECOMMANDATIONS

While we have made many detailed recommendations, relatively few basic changes would be required to make the tax system a better vehicle for allocating the costs of government. The basic changes we propose are: the taxation of the family as a unit, integration of the corporation and personal income taxes, the inclusion of all economic gains in the tax base, the elimination of separate taxes on gifts and bequests, and the revision of concessionary allowances to make them more equitable. Because the inclusion of all economic gains would result in a substantial broadening of the tax base, these proposed changes would permit a significant reduction in tax rates. To make clear the main thrust of our proposals it is helpful to consider some examples of the changes in taxes that would be brought about by adopting a system embodying these basic changes.

All of the economic gains of many taxpayers are now taxed. This is particularly true of employees. Table 1 shows how taxes are calculated under the present system and would be taxed under the proposed system for a married taxpayer with two dependent children (eligible for family allowance) who has wages and salary

TABLE 1

TAX CALCULATION FOR A MARRIED TAXPAYER WITH TWO DEPENDENT CHILDREN WITH WAGE AND SALARY INCOME ONLY

	Salary Income of $5,000		Salary Income of $35,000	
	Under Current System	Under Our Proposals	Under Current System	Under Our Proposals
Comprehensive Base Income				
Wages and salaries	$5,000	$5,000	$35,000	$35,000
Less: Employment expenses and unemployment insurance premium	-	199	-	549
Net employment income for tax purposes	$5,000	$4,801	$35,000	$34,451
Family allowances	-	144	-	144
Total Assessable Income	$5,000	$4,945	$35,000	$34,595
Deductions:				
Standard deduction and family exemptions	2,700	50	2,700	50
Taxable Income	$2,300	$4,895	$32,300	$34,545
Gross Tax	$ 281	$ 438	$12,200	$ 9,004
Tax credits:				
Credit for dependants	-	160	-	160
Personal Income Tax	$ 281	$ 278	$12,200	$ 8,844
Old age security tax	92	-	120	-
Total Income Taxes	$ 373	$ 278	$12,320	$ 8,844

Note: Personal income taxes are before abatements to the provinces and are calculated under the current tax system using 1966 rates. Standard deductions of $100 under the current system and $50 under our proposals are used in calculating taxable income. The recommended minimum allowance of 3 per cent of employment income up to a $500 maximum is used for employment expenses. It is assumed that both dependent children receive family allowances of $6 per month, and that only one member of the family receives income, all in the form of wages and salary.

and no other income except for family allowances received on behalf of his children. The examples given in the table show the difference in tax that would result from adopting our proposals when wage and salary income is $5,000 and $35,000. As these examples show, comprehensive income is actually smaller than currently assessable income for such taxpayers, because we recommend the allowance of employment expense deductions that are disallowed under the current tax law. Table 1 is based on the assumption that the taxpayer takes the recommended optional allowance under the proposed system rather than the itemized employment expenses.

Because assessable income is essentially unchanged in these examples, the application of the suggested rate schedules results in both cases in a substantial reduction of total income taxes.

These examples show how taxes would be calculated using our recommended tax rates and tax credits in place of the current tax rates and exemptions. It can be seen that there are no exemptions under our proposals. The $1,000 and $2,000 personal exemptions have simply been replaced by zero rate brackets in the recommended rate schedules, thus bringing taxable income closer to actual income without increasing taxes. Other exemptions have been replaced by tax credits.

The effect of the substitution of tax credits for exemptions is illustrated by comparing the changes in tax that would result if the married couple with $5,000 in wages and salaries (Table 1) had no dependent children. Under the present system the exemptions claimed for their dependent children reduce their taxes from $499 to $373, that is, by $126. Under the proposed system, the net effect of including family allowances in income and of claiming the tax credits for their dependent children would be to reduce their taxes from $412 to $278, a reduction of $134.

Table 2 provides examples showing how taxes would be calculated for married taxpayers, again with two dependent children, who currently have incomes

TABLE 2

TAX CALCULATION FOR A MARRIED TAXPAYER WITH TWO DEPENDENT CHILDREN WITH CORPORATE SOURCE INCOME ONLY

	Corporate Source Income of $25,000		Corporate Source Income of $175,000	
	Under Current System	Under Our Proposals	Under Current System	Under Our Proposals
Comprehensive Base Income				
Dividends	$ 5,000	$ 5,000	$35,000	$35,000
Corporation tax paid	10,000	10,000	70,000	70,000
Capital gain due to retained earnings	5,000	5,000	35,000	35,000
"Goodwill" capital gains	5,000	5,000	35,000	35,000
Corporate source income	25,000	25,000	175,000	175,000
Family allowances	144	144	144	144
Total Income	$25,144	$25,144	$175,144	$175,144
Total Assessable Income	$ 5,000	$25,144	$35,000	$175,144
Deductions:				
Standard deduction and family exemptions	2,700	50	2,700	50
Taxable Income	$ 2,300	$25,094	$32,300	$175,094
Gross Tax	$ 281	$ 5,560	$12,200	$76,224
Non-refundable tax credits:				
Credit for dependants	-	160	-	160
Dividend tax credit	1,000	-	7,000	-
	-	$ 5,400	$ 5,200	$76,064
Refundable tax credit:				
Corporation taxes attributed	-	10,000	-	70,000
Personal Income Tax	-	($4,600)	$ 5,200	$ 6,064
Old age security tax	92	-	120	-
Corporation income tax	$10,000	$10,000	70,000	70,000
Total Direct Taxes	$10,092	$ 5,400	$75,320	$76,064

Note: As in Table 1. Corporation income tax under the current system is calculated assuming that all corporate income is taxed at a rate of 50 per cent. The assessable income under the current system is limited to the dividends received. It is also assumed that dividends are equal to retentions, that total corporate income is unchanged by our proposals and that "goodwill" capital gains, which reflect the premium that a prospective shareholder is willing to pay for the anticipated earnings of the corporation, are equal to dividends. Direct taxes include personal and corporation income taxes and gift and estate taxes.

(as we define the term) of $25,000 and $175,000 solely from dividends and capital gains on common stocks of large corporations whose tax base would not be affected by our proposals. These examples illustrate how integration would affect the total taxes paid on corporate source income attributable to shareholders.

Under the present tax system, only dividends received are brought into the personal income tax base; the taxpayer with dividend income of $5,000 consequently pays only the old age security tax as the dividend tax credit more than offsets the income tax otherwise payable. However, $10,000 in corporation income tax is paid by the corporation on the share of its income attributable to the shareholder.

A closely held company could conceivably be organized as a partnership instead of as a corporation. If it was, the total income of the partnership would be brought into the tax bases of the individual partners in proportion to their shares in the partnership. The only tax paid on the income of the partnership would then be the personal income taxes of the partners.

As Table 2 indicates, the effect of our recommendation to integrate the personal and corporation income taxes would be essentially to tax the income from all corporate shares held by residents as if they were shares in a partnership. Corporation income tax would be paid by the corporation, but all before-tax corporate income attributable to a shareholder would be added to his tax base. The shareholder would be allowed a refundable tax credit equal to all corporation income taxes attributable to his share of the corporation's profits. The effect of integration would thus be to tax corporate income at the shareholder's personal rate, rather than at the 50 per cent rate of the corporation income tax plus any subsequent tax on distributions. From our viewpoint there should be no difference in taxes as a result of

the form of organization chosen for a business; the assessable income of the taxpayers in this example would be $25,144 rather than $5,000 and $175,144 rather than $35,000.

We have assumed in the examples in Table 2 that the taxpayer realizes "goodwill" capital gains (i.e., capital gains in excess of the gain that results from corporate retained earnings and which reflect the premium that a prospective shareholder is willing to pay for the anticipated earnings of the corporation) equal to the dividends on his shares. Even when these gains are added to the base, total taxes would be reduced in the first example and increased only slightly in the second.

The examples presented in Tables 1 and 2 show how two kinds of income are taxed at two income levels. Similar examples for taxpayers in many different income classes are presented in Appendix I to Volume 3 and Appendix M to Volume 4 of this Report.

One clear implication of these examples is that they cannot be typical of all taxpayers for taxes would be reduced under our proposals in all but one case. The primary reason for the reductions in three of the four cases is that assessable income was not increased sufficiently to offset the effects of integration and of the reductions in tax rates. While this would be true for most taxpayers it would not be true for all.

Table 3 presents an example of a taxpayer with an income of $35,000 for whom assessable income would be greatly increased by our recommendations. This example is indicative of the effects of our proposals on many upper income taxpayers receiving substantial income from non-corporate investments and from gifts from outside their family units. Even though gift taxes would be eliminated under our proposals, in this example total direct taxes would be increased by more than 40 per cent.

TABLE 3

TAX CALCULATION FOR A MARRIED TAXPAYER WITH TWO DEPENDENT CHILDREN RECEIVING NON-CORPORATE SOURCE INVESTMENT INCOME OF $25,000 AND $10,000 IN GIFTS

	Under Current System	Under Our Proposals
Comprehensive Base Income		
Investment income currently taxable	$20,000	$20,000
Capital gains	5,000	5,000
Total investment income	$25,000	$25,000
Gifts	10,000	10,000
Family allowances	144	144
Total Income	$35,144	$35,144
Total Assessable Income	$20,000	$35,144
Deductions:		
Standard deduction and family exemptions	2,700	50
Taxable Income	$17,300	$35,094
Gross Tax	$ 5,085	$ 9,212
Tax credits:		
Credit for dependants	-	160
Personal Income Tax	$ 5,085	$ 9,052
Old age security tax	120	-
Gift tax attributable	1,100	-
Total Direct Taxes	$ 6,305	$ 9,052

Note: As in Table 1. It is assumed in calculating gift taxes paid on the gift of $10,000 that the donor has used up his gift tax exemption for the year and that the gift is fully taxable but subject only to the 11 per cent rate. Because so many gifts are now exempt, this assumption results in a higher than average rate of tax being applied to the gift in this example. Direct taxes are defined to include personal income taxes, corporation income taxes and gift and death taxes.

REVENUE IMPLICATIONS

As the previous examples indicate, the base and rate changes we recommend would interact in an extremely complex manner. The revenue implications are therefore neither obvious nor easily explained because some of the changes would complement one another while others would offset one another. To cope with this complexity we have based our estimates on data for the year 1964, the latest year for which detailed information was available. We had computer work done for us to adjust the actual income reported by a large number of taxpayers in that year in accordance with our recommendations and to recompute their taxes with the rate schedules we recommend.

In completing our revenue estimates we have been forced to make a number of assumptions, since little or no information is available with respect to such matters as the annual gifts made between tax units, the value of property gains that would be realized each year and the extent to which interest is not reported. We are satisfied, however, that even if the amounts of such income are less than we have assumed the proposed system would raise a sufficient flow of revenue.

On the basis of these calculations we estimate that had our proposals been in effect in 1964, and had there been no revenue losses in that year as a result of the transition from the present to the proposed system, over $200 million more in revenue would have been raised than would have been raised under the present system. The changes, categorized by the major revenue sources affected, are given in Table 4.

These estimates must be interpreted with caution. The large increase in corporation tax collections would result primarily from withdrawal of the dual rate of corporation tax, withdrawal of some industry concessions and the full taxation of realized property gains to corporations. A

substantial part of this increase would fall on Canadian corporate source income attributable to non-residents. More important, the increased corporation tax collections do not mean that the corporate source income of residents would be more heavily taxed, for the increases at the corporate level would be offset, and in most cases more than offset, by reduced taxes on corporate earnings at the personal level.

The elimination of gift and estate tax collections would not mean that gifts and bequests would escape tax altogether. This would be true only of intra-family gifts and bequests. Other gifts would be taxed to the recipients at full personal rates. The revenue raised in this way is, of course, taken into account in arriving at the estimated net change in personal income tax collections.

The estimated reduction in sales tax revenues would result from moving from a manufacturer's sales tax to a retail sales tax, broadening the base in some respects while narrowing it in others, eliminating certain taxes on "luxury" goods, and replacing the 11 per cent rate on the present base with a 7 per cent rate on the proposed base.

TABLE 4

PROPOSED REVENUE CHANGES FOR 1964
(millions of dollars)

	Present System	Proposed System	Change
Corporation income taxes	1,941	2,473	+532
Personal income tax	2,676	2,634	-42
Gift and estate taxes	143	-	-143
Sales and excise taxes	1,597	1,472	-125
Total	6,357	6,579	+222

It is useful to consider the revenue changes that would result from our income tax proposals classified by reform rather than by type of tax. Using one of several alternative methods of proration, we estimate that the results for 1964, still ignoring transitional adjustments, would have been as shown in Table 5.

These figures disguise the fact that the taxes on the Canadian corporate source income of non-residents would have been increased in 1964 by about $271 million so that the total taxes imposed on residents would have been reduced by approximately $49 million.

TABLE 5

EFFECTS OF DIFFERENT PROPOSED REFORMS
ON 1964 TAX REVENUES
(millions of dollars)

Net reduction in personal income tax rates	-317
Increases in the personal income tax base (excluding the effects of integration)	+838
Integration of corporation and personal income taxes	-111
Additions to the integrated corporation tax base	+252
Increased personal deductions	-151
Extension of the corporation tax credit to certain tax-exempt intermediaries	-50
Changes in concessionary allowances	-99
More liberal income averaging	-60
Aggregation of incomes in family tax units	+45
Changes in sales and excise taxes	-125
Total change	+222

During a transitional period revenues would be less than those estimated above. This would arise in part because some of our proposals would have a gradual impact on revenues and because we have recommended some concessions to soften the immediate impact of certain major recommendations. The rates of personal tax that we recommend, in conjunction with a suggested change in the time of paying corporation tax instalments, would raise sufficient revenue to finance the transitional costs that would be involved during the initial 3 to 5 years, the duration of the transitional period depending upon the actual transitional measures adopted. After this transitional period the proposed personal tax rate schedule applied to the proposed base would therefore raise substantially more revenue than the present system would raise at the same point in time.

INCIDENCE IMPLICATIONS

Under the present tax system low income families pay a surprisingly high proportion of their income in taxes to all levels of government. As a group, families with the largest incomes pay only a slightly higher proportion of their income in taxes than do those with much lower incomes. The term "incomes" as used above is intended to denote the all-inclusive concept described in this Report as the "comprehensive tax base".

This inadequacy of the progressiveness of the present tax system is probably more than offset by the larger benefits received by the low income taxpayer from government expenditures in proportion to his income. Nevertheless, we believe that some low income families are overtaxed because they do not benefit as much from government expenditures as other families with the same income. We also believe that some upper income families are not making a sufficiently large net contribution to this redistribution of income. Adoption of the system we recommend would significantly increase the progressiveness of the tax system.

Reducing the weight of sales taxes and adding services to the sales tax base would reduce the burden of these taxes on lower income individuals and families and increase the burden on those with larger incomes. On the average, sales taxes would be reduced by approximately 8 per cent.

Estimates of the average effective rates of federal direct taxes (before provincial abatements) by income class under the present and proposed systems are plotted in Chart 1. These federal direct taxes are the personal and corporation income taxes and the gift and estate taxes. It is assumed that no shifting of the corporation tax occurs, but in any case a study made for us shows that incidence estimates are not highly sensitive to assumptions as to shifting.

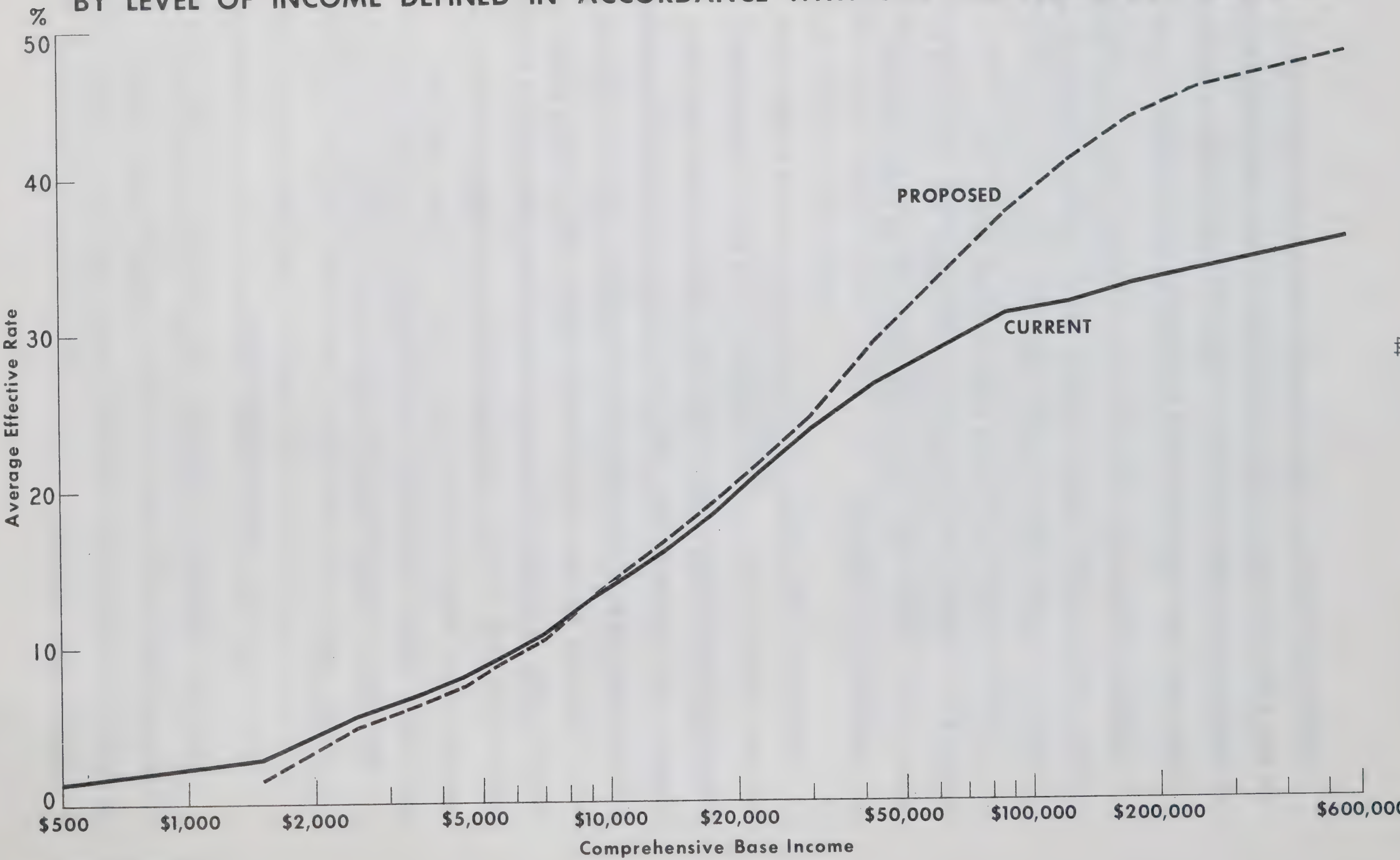
Averages are often misleading; the present and proposed average direct tax rates plotted in Chart 1 are no exception. They hide an extraordinary diversity in the changes in direct taxes that would be brought about by adoption of our recommendations. While the average low income family would pay lower taxes, some of these families would pay more. The same diversity would be found at the upper end of the income scale. This is shown by the estimates given in Table 6. The data provided in this table give the estimated number of taxpayers in each income class who would experience increases, decreases and no changes in direct taxes. While it is clear that most lower income taxpayers would benefit from reductions in direct taxes and most upper income taxpayers would be subject to tax increases, there would be many exceptions.

ECONOMIC IMPLICATIONS

There is no doubt that the proposed increase in the progressiveness of the system would tend to reduce the rate of personal saving. However, the reduction would probably be insignificant and could readily be offset by changes in other policies.

Chart 1

AVERAGE EFFECTIVE RATES OF FEDERAL DIRECT TAXES FOR RESIDENTS, BY LEVEL OF INCOME DEFINED IN ACCORDANCE WITH OUR COMPREHENSIVE TAX BASE



Source : Chapter 36

TABLE 6

NUMBER OF TAXPAYERS IN DIFFERENT INCOME GROUPS THAT IN 1964 WOULD HAVE EXPERIENCED RELATIVE CHANGES IN FEDERAL DIRECT TAXES OF GIVEN AMOUNTS UNDER THE PROPOSED SYSTEM

Comprehensive Income	Decreased by more than 15 per cent	Changed by less than 15 per cent	Increased by more than 15 per cent
Less than $5,000	2,713,328	1,685,259	370,048
$ 5,000 - 9,999	404,144	1,038,796	173,338
10,000 - 14,999	5,269	125,901	37,960
15,000 - 24,999	1,895	70,918	23,885
25,000 or more	182	42,263	26,259
Total	3,124,818	2,963,137	631,490

Note: Federal direct taxes include personal and corporation income taxes and gift and estate taxes before provincial abatements.

Of greater moment is the likely effect of the recommended system on the rate of business saving and the rate of capital expenditures. Adoption of our recommendations would increase corporation tax collections by about 25 per cent. Although this increase would take place only gradually, obviously it would substantially reduce corporate cash flow. Part of this reduced cash flow would be absorbed by reduced corporate retentions, a major source of business saving. If reduced business saving were the only result of our recommended tax changes, conceivably the rate of capital expenditures would decline.

Several other crucial factors must be borne in mind, some of which would offset this negative effect on capital expenditures in varying degrees.

1. While an increase in tax collections at the corporate level of more than $500 million can hardly be dismissed as trivial, this would only represent about 6 per cent of total business saving.

2. Over 40 per cent of the increase in corporation tax would result from abandoning the dual rate. This would not significantly change the taxes of large public companies, for the maximum annual increase per company would be about $10,000 and the change would not alter the after-tax return on capital expenditures. For low income closely held corporations owned by residents, the tax increase at the corporate level resulting from the withdrawal of the dual rate would have no significance unless the shareholders had high incomes. This is because tax reductions at the personal level with respect to this income would offset the tax increases at the corporate level. For Canadian corporations controlled by non-residents, the abolition of the dual rate usually would have no significance because the increased Canadian tax would be offset by a larger foreign tax credit provided by the country in which the shareholders were resident.

3. Almost one half of the increase in corporation tax collections would result from the withdrawal of special concessions to certain industries. Most corporations in these industries would not be affected, or would not be affected significantly. The cash flow of a few large mining, petroleum and life insurance companies would be significantly reduced. It would be surprising if this was not reflected in lower retentions by these corporations and a reduced rate of capital expenditures. It should not be forgotten, however, that a handful of large, internationally controlled corporations would account for most of the tax increase for the extractive industries. Because the special concessions to the mining and petroleum industries are so inefficient, for the most part subsidizing projects that would have been undertaken in their absence, the resulting reduction in capital expenditures would not be as great as the increase in tax revenue might suggest. Increasing the taxes on life insurance companies may change the form of personal saving but would be unlikely to have a significant effect on the amount of saving.

4. On the positive side, most Canadian corporations owned by residents would not experience significant increases in tax at the corporate level, while their low and middle income shareholders would experience substantial tax reductions with respect to Canadian corporate source income. The after-tax return from Canadian equities to these shareholders would in general increase because of the integration of corporation and personal taxes and despite the full taxation of share gains.

5. As a result of allowing Registered Retirement Income Plans full credit for the corporation tax, and of not taxing their realized share gains (the beneficiaries would be taxed in full on all income they received but there would be a valuable time postponement) the cash flow and after-tax return of such plans from common stocks would also increase.

6. With higher after-tax returns from the common shares of Canadian corporations to most resident shareholders, these corporations would find that it would be in the interest of their shareholders to increase their rates of capital expansion. Projects that would have been rejected under the present tax system would be attractive under the proposed system.

7. Canadian corporations could gradually reduce the proportion of their after-tax income distributed because the tax changes at the personal level would increase the cash flow to low and middle income shareholders.

8. Higher share prices would encourage more new equity issues to finance the increased rate of capital expenditures by these companies.

Bearing all of these offsetting effects in mind we believe that there would be no decline in the rate of business saving or investment.

On the contrary, we are confident that with lower marginal rates of tax on wages and salaries to encourage labour and managerial effort, with little change in the rate of capital formation and with a much improved allocation of capital, the future output of the goods and services Canadians want would be increased.

FEDERAL-PROVINCIAL TAX SHARING

It is not the task of the Commission to recommend how tax revenues should be shared between the federal and provincial governments. This is a problem that can only be "solved" at the bargaining table.

We have constantly borne in mind, however, that our recommendations would have great significance for the provinces. We have tried to design a system that is consistent with their needs, as well as the needs of the federal government, and sufficiently flexible to meet changes in the needs of both.

We have not been deterred by the great debate about federal-provincial fiscal relations. We have recommended radical changes in the tax system of the federal government which on implementation would bring to bear very strong influences for change in the tax systems of the provinces. We advocate more joint decision making, particularly with respect to stabilization policy and tax structure policy. We recommend that the federal government adopt a policy that would stabilize provincial revenues and hence expenditures in periods of unemployment and inflation. To facilitate adoption of our major proposal for integration of the corporation and personal income taxes we suggest that the corporate field be used exclusively by the federal government. The loss of revenue to the provinces could be made up either by a sharing of the federal revenues from the corporation tax or by a transfer of more sales tax room by the federal government to the provinces. We advocate a constitutional amendment that would allow the provinces to levy an indirect retail sales tax. We advise the federal

government to resist providing the provinces with more personal income tax room, at least until a joint federal-provincial stabilization strategy has been developed. Also, we recommend that the federal government seek to persuade the provinces to abandon their succession duties to allow the federal government to collect on their behalf personal income taxes which would be imposed on a base common with that used by the federal government. Similarly, we hope that the federal government can persuade the provinces to collect on its behalf sales taxes which would be levied on a base common with that used by all the provinces.

CONCLUSION

Preparing this Report has been a large undertaking, and the result is a long and complex document. Despite its length there are many questions with which we have not dealt. Despite its complexity we have often had to over-simplify and to ignore problems that we would like to have discussed.

We hope that our proposals emerge clearly and strongly; it is the basic ideas from which the proposals have been derived and not the details that are important. We hope too that these ideas, as embodied in our recommendations, will commend themselves to our countrymen, for we believe that by their adoption Canada would achieve a tax system that was equitable, efficient, and consistent with the attainment of its economic objectives.

MINORITY REPORT OF COMMISSIONER A. EMILE BEAUVAIS

I regret being unable to share the opinion of the majority of the Commissioners on certain fundamental principles and on certain major and minor recommendations as enunciated in the Report. I am therefore presenting a Minority Report expressing my dissenting views and my own recommendations.

In Volume 1, under the title "Introduction" as well as in Chapters 7, 8 and 9 of Volume 3, a summary of the recommendations is given. In so far as my Minority Report is concerned, I briefly mention my objections to certain of these recommendations and comment more extensively on them under the headings of the various chapters that deal with the particular recommendations.

In order to present a ready reference to my objections, I have classified my report according to the chapters in which the recommendations to which I object appear.

VOLUME 3

CHAPTER 7

TAXATION BASED ON ABILITY TO PAY

In the conclusions and recommendations, I do not agree with the following:

THE COMPREHENSIVE TAX BASE

"14. ...we recommend that the tax base should include the change in each tax unit's economic power each year".

This is what the Report calls the comprehensive tax base because it includes, in principle, all additions to economic power without regard to source, intention or form, and whether consumed or saved. My objections

to this comprehensive tax base as proposed are discussed in my remarks on Chapter 8.

THE INCOME OF ORGANIZATIONS AS A TAX BASE

"16. Intermediaries such as corporations and trusts should not be regarded as entities with tax-paying capacity".

I do not share this opinion as expressed in the Report and will deal with this subject later in my comments on Chapter 19.

CHAPTER 8

BASIC FEATURES OF THE COMPREHENSIVE TAX BASE

NET GAINS FORMULATION

In the conclusions and recommendations, the definition of the comprehensive tax base as expressed in Chapter 7 is reformulated, and it clearly stipulates that it includes gains from all sources including those considered at present as capital gains. I am opposed to this definition of the tax base and deal with this subject more fully later.

PERSONAL EXPENDITURE

It seems harsh to suggest that the net losses of operating a business should not be deducted from other income if there is no expectation of generating a net gain. Such an expectation might be very difficult to determine.

VALUATION OF BENEFITS IN KIND

It would seem that the Report recommends extra precautions to tax small benefits in kind at present received by employees, such as free playgrounds for children, free parking, etc., and I shall comment on this later.

REALIZATION OF GAINS

I am against recommending that a realization be deemed to take place when an individual dies.

TREATMENT OF INTERMEDIARIES

In so far as corporations are concerned, the recommendation that resident tax units be given a full credit for the taxes collected from intermediaries is commented upon in my remarks on Chapter 19.

CHAPTER 9

THE PRESENT AND PROPOSED TAX SYSTEMS

The conclusions and recommendations are nearly all commented upon in the following chapters, so here I shall refer only briefly to the recommendations I am not in accord with and shall elaborate on my objections later when dealing with specific chapters.

COMPREHENSIVE TAX BASE

I do not share the Report's recommendation that the tax base should, as a practical matter, be measured by the net value of virtually all receipts, gains and benefits realized during the year.

PROPERTY GAINS

I am not opposed to the taxation of capital gains, but think that it should be limited to gains from the sale of certain assets specified on a list, primarily securities and real estate, which were held for a certain time; the tax should be based on the measures currently applied under the United States Internal Revenue Code, so that an amount equivalent to 50 per cent of the gain should be taxable at progressive rates, with a maximum rate of 50 per cent.

GIFTS AND INHERITANCES

Inheritances should be considered as gifts and taxed as capital gains in accordance with the method described above.

EXCLUSIONS FROM INCOME

I would exclude from the tax base all gains that are at present non-taxable, with the exception of those gains that would be subject to a capital gains tax on the basis mentioned above. Specifically, I would not include mortality gains from the proceeds of insurance policies.

BUSINESS LOSSES

I cannot adopt the recommendation in connection with the disallowance of a business loss as a deduction from other income after a certain number of years.

CLASSES OF TAXPAYERS

I am opposed to the recommendation that a full credit for the corporation tax should be given to resident shareholders.

CHAPTER 10

THE TAX UNIT

It is recommended that upon the termination of a family unit tax should be payable on the unrealized property gains of the family. I am opposed to any tax on unrealized gains. The tax should be paid only if and when the gain is realized. It might not be possible to obtain cash for the deemed gains if, for instance, the property transferred was a non-liquid asset. If a child leaving a family unit had to pay tax on the value of a gift received while he was part of the family unit, and if there was an unrealized gain in the value of such a gift on which the family unit would have to pay tax at the same time, this would be double taxation on the gain.

It is recommended that all income of dependent children be aggregated with family income and that an exemption of $500 of earned income be allowed for each dependant. At present, a dependant can earn up to $950 before being disallowed as a dependant, in which case he files a personal income tax return and pays tax at the applicable rate.

If the Report's recommendation is adopted, it would mean that the earned income of each dependant over $500 would be added to the family income and taxed at the family's top marginal rate. I am of the opinion that the present $950 exemption should be maintained. If a child earned more, then the parents should not be entitled to the tax credit for dependants, the earned income of the dependant should not be added to the family income and he would pay his own income tax.

It is recommended that when a child in the family unit received a gift or a bequest from outside his family unit he should be permitted to deposit it in his name in an interest-bearing Income Adjustment Account in the year in which it was received. But when gifts or bequests are made in kind to the donee, the parent might have to borrow either to deposit the monetary value of the gift in the Account or to pay the tax thereon, should the deposit not be made. I suggest as an alternative that in such a case the donor himself should be allowed to pay the tax involved.

In the case of a bequest, I would suggest that the estate of the deceased should have the same right and that the bequest should be taxed as a capital gain at a preferential rate.

CHAPTER 12

CONCESSIONARY ALLOWANCES

According to the Report, when a gift was made of an item of property that had appreciated in value, a capital gain would be deemed to be realized and would be taxable. This might prevent many taxpayers from making gifts to universities, museums, etc. of valuable property that was not readily

salable, for example, an art collection. In such cases, I would not support this recommendation.

The Report recommends that when a close relative is provided with room and board in the home of a taxpayer throughout the year, it should be deemed that the taxpayer had made a gift of $1,000 less any amount contributed by the relative toward the cost of room and board. A recipient of these gifts would be required to bring them into income.

I am opposed to this recommendation as it is anti-social.

GIFTS TO CLOSE RELATIVES

It is recommended that a tax credit of $100 should be provided to a tax unit making gifts of $1,000 or more in a year to a close relative outside the tax unit. I am of the opinion that this tax credit is not enough and I comment further on this subject in my remarks on Chapter 17.

THE AGED

The Report recommends that the following section be repealed. Section 26(1)(e)—"For the purpose of computing the taxable income of an individual in a taxation year, there may be deducted from his income for the year $500 in the case of a taxpayer who has attained the age of 70 years before the end of the year".

I now refer to Volume 6, Chapter 36—"Incidence of the Proposed System", and I quote: "Integration of the corporation and personal income taxes and elimination of taxes on intra-family gifts and bequests would result in further tax decreases for most taxpayers. The effect of the proposed changes in concessionary allowances would generally be minor."

"As Table 36-3 indicates, these generalizations do not apply in all cases. A significant exception is presented for low income pensioners with some investment income—the last of the seven examples. Fewer than 2,000

taxpayers fall into this group. The average taxes of these taxpayers would be significantly increased, primarily because of the effect of bringing more investment income into the tax base and of eliminating the $500 special deduction for taxpayers over seventy. In order to treat equally all taxpayers who had equal incomes and responsibilities, it would be necessary to raise taxes for some individuals. If some of these effects were considered undesirable we believe they should be countered directly through transfer payments rather than by altering the tax system".

I refer to Table B-9 of Appendix B to Volume 6, "Calculation of Taxes for the Average Taxpayer in Example Group 7", being pensioners with assessable income of $1,500 to $1,749 (as defined under 1964 Tax Law). Total direct taxes for this group of taxpayers are presently $140 and would be $250 under the Report's proposals, an increase of 78 per cent.

For this reason, I cannot support the recommendation that section 26(1)(e) be repealed until an equivalent transfer payment be provided for its replacement.

CHAPTER 13

INCOME AVERAGING

14. The Report recommends that a system of Income Adjustment Accounts be established that would make it possible for taxpayers who expected reductions in future income to reduce their current income by making non-negotiable, non-interest-bearing deposits with the government. The Report states that because the deposits would bear no interest, taxpayers would pay a price for tax postponement. I cannot support this recommendation in so far as it would deny the payment of any interest, and I would suggest that a modest rate of interest, say, 2 per cent be paid, since part of it would be returned anyway to the federal treasury.

CHAPTER 14

EMPLOYMENT INCOME

It is recommended in the _Report_ that the value of meals regularly provided free or at low cost, free or low rent housing, and the direct cost of schooling for children of employees be included in the employees' income. I am against this recommendation. It is imperative that in certain regions industries give these benefits in order to obtain the employees they need.

It is also recommended that the actual expenses of an employee for meals and lodging while away from home on a bona fide business trip and paid by an employer should not exceed about $25 a day at current prices, and that two conferences a year, with a maximum registration fee of $35 to $50 a conference, probably would be sensible limits. However, the _Report_ says that the limits might vary with the salary of the employee and _perhaps_ should take into consideration the size of the city or town visited by the employee. It also says that these limits are stated only to give an indication of the thinking of the majority of the Commissioners and suggests that the detailed limits should be determined after a careful review of living costs and in consultation with the informal advisory committee of non-governmental experts that it recommends in Chapter 32.

The _Report_ also recommends that the upper limit of cost of entertainment should be $5 to $10 per person entertained a day, but here again, consultation with the informal advisory committee is suggested. I am opposed to the statement in the _Report_ as to what amounts would be reasonable for entertainment expenses, for meals and lodging for an employee while travelling on a business trip. The amounts stipulated should depend on the circumstances, such as the position of the employee, the importance of the trip, the city or town visited, etc.

It would be quite a hardship for an executive employee to be obliged to spend in travelling and entertainment expenses an amount in excess of the limits mentioned and to be taxed personally on the difference. Fees paid by employers for educational courses taken by employees, scholarships, fellowships, bursaries and awards provided by employers for their employees should not be included in employment income.

GROSS GAINS

The Report says in the conclusions and recommendations:

"9. The Act should include a general charging provision that would bring all receipts, gains and benefits into the tax base of the individual or family. This would bring into tax all forms of employment income, including wages, salaries, bonuses and gratuities. For greater certainty, the Regulations should also specify certain expenditures, or revenues forgone by employers, that would be deemed to provide a benefit to employees (or others)".

"10. The value of these deemed benefits should be reported by the employer to the employees (or others), and included in their incomes, or the employer should be required to pay a special tax on them".

"11. The special tax on the employer would apply when the employer was unable or unwilling to allocate benefits to individuals. The tax would be imposed at the top personal rate on the before-tax income that an individual paying tax at that rate would have to receive in order to buy the benefit in the market with after-tax income. The special tax would itself be deductible in computing the employer's income. There would therefore be no tax saving, and possibly an increase in the tax cost, if the employer provided non-cash benefits that were not taxed to the employee (or others)".

I feel that if an employer incurs a business expense to provide benefits for his employees but is unable to allocate benefits to them, the employer should not be penalized and should not pay a special tax on the amount of such benefits.

INSURANCE PREMIUMS

I am against taxing the mortality gain on the proceeds of group life insurance and therefore I am of the opinion that premiums on group life insurance policies should not be deductible by the employees if paid by them.

CHAPTER 15

PROPERTY INCOME

This chapter contains some of the main recommendations of the Report and my objections to them can be summarized as follows:

1. I am opposed to the comprehensive tax base and to full integration as expressed in the Report.

2. I do not subscribe to the recommendation expressed in the Report that the comprehensive tax base as defined should include the value of all additions to the taxpayer's economic power, including so-called capital gains.

3. I am not opposed to a capital gains tax, but think that it should be limited to gains from the sale of certain assets specified in a list, primarily securities and real estate which were held for a certain time; the tax should be based on the measures currently applied under the United States Internal Revenue Code, so that an amount equivalent to 50 per cent of the gain should be taxable at progressive rates but with a maximum rate of 50 per cent.

In most countries in the western world capital gains are taxed at special rates; such gains arise mainly from sales of securities and real estate. If my information is correct, Canada would be the only country in the western world to tax so-called capital gains at full progressive rates and, what is more serious, to tax these gains on a deemed realization basis at death.

In connection with taxing capital gains, I wish to refer to the Canadian Tax Journal (Volume XIII, No. 5, September-October 1965). With the permission of the Canadian Tax Foundation, I am reproducing as an appendix an article published in the Journal regarding capital gains tax. It appears to support my point of view, at least to some extent.

According to the Report, for a tax to be imposed equitably, a wage earner who pays for his car by working overtime and a fellow worker who uses his net gains from the stock market to acquire a car should get an equal tax treatment. I cannot share this philosophy. The wage earner does not take any risk, whereas his fellow worker, who uses his net gains from the stock market to acquire a car, takes the risk of losing his savings.

The Report states that the Commissioners have rejected the line of reasoning that the tax rates applicable to capital gains should vary according to the length of time the property was held, and says: "In this sense, the United States has perpetuated the distinction between 'carrying on business' and 'investing' which we find so unpalatable in the present Canadian position". I do not agree with the above-mentioned assertions and, in so far as the United States concept of distinguishing between 'carrying on business' and 'investing' is concerned, I agree with it.

The Report recommends taxing at full progressive rates the gains deemed to be realized at death. It states: "The comprehensive tax base that we recommend includes all a taxpayer's increments in wealth, whether

realized or not". This view might be right in theory but I feel that a taxpayer or his estate should pay the tax only when a gain is realized and not on a deemed realization basis. I would make an exception in the case of a taxpayer who was leaving the country.

DISPOSITION ON DEATH

A comparison is made between the lifetime tax burden of two taxpayers, with identically lifetime economic incomes, on the assumption that one taxpayer died the day after liquidating all his assets, while the second taxpayer died before any such liquidation. The Report concludes that the tax capacity of the two taxpayers would be identical, but that their tax liability could be drastically different and would be equalized only if there was a deemed disposition for tax purposes on the death of the second taxpayer. I cannot share this view. Both taxpayers had the opportunity of selling their assets and realizing their gains or losses. I do not see the necessity of taxing deemed realizations on death because the first taxpayer took the choice of selling his assets at a certain date. I do not see anything wrong in requiring the federal government to wait until a gain is realized, whether it be before or after the death of a taxpayer.

Moreover, at the death of a taxpayer, his estate would have to pay tax on gains deemed to have been realized and the beneficiaries on the value of their bequest at full progressive rates. This is double taxation in so far as gains are concerned.

The Report mentions: "Although problems of liquidity could arise under our approach because the shareholder might not have the cash available with which to pay the tax, we do not believe that this problem would be sufficiently serious to warrant introducing complex measures that could lead to uncertainty and to tax avoidance". I am sorry to disagree with this assertion. To me it is very important that the shareholder should have the cash available to pay whatever tax might be due as a result of

a transaction. The averaging provisions proposed might decrease his tax liability somewhat but would not provide him with the cash required.

The Report suggests that annual tax returns should include appropriate information as to all securities and property owned. Particulars of all property gains and all deductible property losses would also be required. It imposes an additional burden on taxpayers, and I wonder whether it is fair to require such a statement, which neither the United States nor the United Kingdom has found to be necessary.

CHAPTER 16

DEFERRED INCOME

LIFE INSURANCE

The Report recommends that the tax deferment which results from the transfer of a portion of property income to policy reserves should be compensated for by the imposition of a postponement fee. I am not in favour of such a tax. I would prefer to retain the same tax-free transfers to policy reserves.

It is also recommended that policy dividends should be included in full in the income of the policyholder. I would not object to this taxation of policy dividends on all policies issued after the effective date. But in the case of policies issued before the effective date, and especially old policies, the taxpayer might not have the cash to pay the tax on the dividend. It would be equivalent to a kind of retroactive legislation. Therefore, I suggest that this new tax should apply only to dividends received or deducted from the premiums on policies issued after the effective date.

The Report recommends that mortality gains and losses should eventually be included in the computation of the income of policyholders. However, it does not recommend immediate inclusion of mortality gains and losses from life insurance (other than from group life insurance) unless their inclusion

would be essential to an administratively feasible system of taxing the other income elements of life insurance.

I am opposed to bringing mortality gains into the tax base. Moreover, I am against bringing the proceeds of life insurance policies into the tax base upon death.

REGISTERED RETIREMENT INCOME PLANS

The Report recommends that contributions by both employer and employee should be deductible from income only as long as retirement benefits to the taxpayer from plans other than the Canada Pension Plan (or an alternative provincial pension plan with equivalent provisions) do not exceed the equivalent of a single life annuity of $12,000 a year payable at age sixty-five with a ten-year guarantee.

The present departmental practice allows a limit of $40,000. I am of the opinion that the amount of $12,000 is not enough. It is imperative in the hiring of executives of high quality to offer retirement savings plans of more than $12,000 a year. According to the recommendations contained in the Report, the employee would be taxable on part of the amount charged against the company's income covering the premium paid if the allowable benefit was more than $12,000 per annum. I am of the opinion that a limit of from $25,000 to $30,000 should be recommended.

CHAPTER 17

GIFTS, INCLUDING INHERITANCES

The Report recommends that all gifts, that is all receipts of wealth, whether inter vivos gifts or inheritances or others, should be included in the comprehensive tax base of the recipient and taxed at full progressive rates.

I shall first deal with inter vivos gifts. Under the present legislation, liberal exemptions are allowed, but the Report recommends very

drastic reductions nearly equivalent to their elimination. I am in favour of subjecting the *inter vivos* gifts to full progressive rates of tax, provided that:

1. The donor be allowed to give or pay the amount of tax on behalf of the donee without having to pay a further tax on the amount of the tax so paid.

2. An annual exemption of $1,000 be allowed for gifts to each individual being a parent, a grandparent, a brother, a sister, a son, a daughter, a grandson or a granddaughter. In any other case, I recommend an annual exemption of $500.

The *Report* recommends an annual exemption of $250 for each individual who filed a separate return, $250 for each spouse in a family unit and $100 for each dependant who was a member of a family unit. I am of the opinion that these exemptions are not high enough, and I suggest that my above recommendations be adopted.

Wedding gifts up to an amount of $10,000 should be excluded from the tax base. This would be over and above any other exemptions.

I cannot support the statement that anything which adds to a person's economic power should be included in his tax base. The *Report* adds: "This means that the concept of 'property' should be all-inclusive. Definitions similar to those now in the *Income Tax Act* and the *Estate Tax Act* would appear to be satisfactory". "Property" is defined in the latter Act to include property of every description whatever, whether real or personal, movable or immovable, etc.

To tax everything on which a gain is made is quite a sweeping recommendation. As declared previously, I am against such a recommendation.

PROPERTY PASSING ON DEATH

I recognize that the proposals for the tax-free transfers of wealth between husband and wife on the death of one spouse are a step in the right direction, but I cannot agree that most of the other exemptions and deductions are either not justified or too generous. One must remember that the assets so transferred and not spent would be re-transferred some day and taxed to the recipient at the full progressive rates.

The Report recommends that inheritances be included in the comprehensive tax base of the recipient and taxed at progressive rates. In short, apart from gifts between members of a family unit, inheritances would be taxed in full. Substantial exemptions at death would be eliminated. Furthermore, the rate of tax on inheritances would be sharply increased as the following illustration shows.

Let us assume that a taxpayer's earnings for the last five years were $10,000 a year. The donor is a widower and the donee is married with no children. The bequest is $100,000. Let us compare his tax under the present and proposed systems assuming that:

1. The donee has used up his proposed lifetime exemption.

2. The total estate consists of $100,000 in computing the present tax.

3. No use is made of the proposed Income Adjustment Accounts that make it possible, in effect, to average over 10 years.

4. The Registered Retirement Income Plan limit has already been reached by the donee.

Present System

Salary	$10,000		
Less: Exemptions and standard deduction	2,100		
Taxable Income	$ 7,900		
Income Tax	1,644 x 5 years	$ 8,220	
Death Duties on $60,000		10,200	
			$18,420

Proposed System

Salary	$10,000		
Less : Employment income allowance	300		
Medical and charitable deductions	100		
	$ 9,600		
Add: 1/5 of bequest (bequest less $500 annual exemption in the year the bequest is received)	19,900		
Taxable Income	$29,500		
Income Tax	7,102 x 5 years		$35,510
Difference			$17,090

Thus, this taxpayer would pay 93 per cent more tax than he pays under the present system. If the bequest was in a non-liquid form, the treatment would certainly be very harsh. It would, of course, be an improvement should the taxpayer be allowed a substantial period over which to make the payment and it is recommended in the Report that the taxpayers be granted this privilege on application.

I recommend, however, that bequests be granted a treatment similar to that of capital gains and taxed at the preferential rate suggested in my report.

Moreover, the adoption of the Report's recommendations would necessitate the abolition of the present succession duties in the provinces of Quebec, Ontario and British Columbia.

The Report proposes that when, under the provisions of a will, a bequest is made on the basis that any tax is to be paid by the estate and not by the beneficiary, the amount of the tax paid by the estate should be considered as another bequest or gift. This leads to a series of gifts of tax on tax. The Report says that the sum of this series can be readily calculated by the use of a mathematical formula. However, this leads to complications when the result puts the beneficiary in a higher bracket, but the correct answer can be obtained by the application of an adjusted formula.

I would suggest that tax paid by an estate should not be subject to a further tax thereon.

REPORTING

The Report states it would be necessary to provide that donors or their personal representatives report any gifts made to any individual other than a member of the donor's family unit which were over $100 in any taxation year. This amount appears to me to be too low. If a father gave his non-dependent son a Christmas present of $150 he would have to report it. I would suggest that only gifts over $1,000, should be reported as is now the case.

ANNUITIES AND LIFE INTERESTS

This important matter is mentioned on page 610, Appendix F to Volume 3, subparagraph 2 of the Report.

It says that: "Annuitants and the beneficiaries of life interests, including widows who were beneficiaries of pensions under a provision for a joint life pension with continued payments to the survivor, would pay tax on the full amount of payments received as and when received, assuming that our recommendations with respect to tax-free transfers within the family unit were not accepted. If the annuitant or life tenant died

prematurely, there would be no liability for tax in respect of payments which were not ultimately received, as may be the case under the present Estate Tax Act, which contains only limited provisions for adjusting the tax in case of premature death of an annuitant".

I wish to add that if the Report's recommendations with respect to tax-free transfers within the family unit were not accepted, then in such a case the tax liability on the pension payable to a widow survivor should be calculated on the basis of the present value of her life expectancy divided by the number of years of such expectancy. She would be taxed only on the pension received during her lifetime as above mentioned.

VOLUME 4

CHAPTER 19

CORPORATIONS

The majority of the Commissioners recommended that because the corporation tax is paid by the corporation on behalf of the shareholders, the latter, if Canadian residents, should receive credit for the full amount of the corporation tax on after-tax corporate income paid or allocated to them against their personal income tax liabilities, with a refund of the corporation tax if the credit exceeds the liability. I am not in accord with this recommendation. In fact, I am opposed to full integration as recommended in the Report.

I acknowledge the fact that it would greatly simplify the taxation system if such a recommendation were adopted, but I cannot reconcile myself to the idea of wealthy people receiving such a windfall in cases where no special transition tax was paid or in cases where such a tax would be paid when the transitional period has ended. The loss in government revenue from taxes on dividends would have to be compensated for by increasing other taxes which might fall to a certain extent on middle income taxpayers.

Certain passages in the Report support my contention, for example: "However, to arrive at the net effect on the economy it is necessary to consider both the positive effects of the tax reduction and the negative effects of the tax increases that must be made elsewhere if revenues were to be maintained", and further: "Even with the taxation of capital gains at full rates, implementation of our integration proposal would probably give rise to gains to some shareholders".

I would like to make two comments on the advantages mentioned in the Report which would presume to support the adoption of the full integration system:

1. "The advantages of, and facility for, tax avoidance by means of 'surplus-stripping' that are inherent in the present tax structure would be removed".

   The proposed system would favour "surplus-stripping" par excellence because all the surplus earned would be distributable tax free, subject, of course, to the implementation of a transition tax, if any.

2. "Tax avoidance through the creation of associated companies to take advantage of the dual rate would be eliminated".

   I feel that this would be to the detriment of many small businesses or to their shareholders, as some would not be able to elect to be taxed as partnerships and might possess very few fixed assets on which they could take accelerated capital cost allowances as recommended elsewhere in the Report. It must be remembered that over 60 per cent of Canadian corporations are earning less than $35,000 per annum.

Commenting on closely held corporations, the Report says: "The realization of share gains on death would create a tax liability for the difference between the cost basis of the shares and their market value, including the goodwill element. However, if closely held companies and their shareholders took advantage of our various proposals by making

regular allocations of earnings and thereby obtained credit for corporation tax and an upward revision in the cost basis of the shares, the impact of the disposition on death should be reduced".

It seems evident that if, after the effective date, the value of the shares increased as a result of an increase in the value of goodwill, higher earnings and inflation, the problem of deemed realization on death would remain serious. To the tax payable by the estate of the deceased shareholder would be added a tax on bequests payable by the recipients at full progressive rates. I wish to repeat my opposition to the recommendation of taxing gains deemed to be realized on death. As for taxing bequests, my comments are given under "Gifts, Including Inheritances - Property Passing on Death, Chapter 17".

Recommendation 34 says: "The revenue from the full taxation of share gains and from the elimination of most of the special corporation tax concessions would grow very slowly, while the revenue loss from integration would be immediate. If the economic conditions at the time the legislation was to be amended made it necessary to maintain the level of government revenues, two acceptable alternatives would be available to accomplish such an objective. The general level of tax on all income of resident individuals could be increased temporarily, or a special tax applicable only to corporate source income could be imposed for a transitional period. We favour the first approach, but in the event that the second alternative was chosen, we have outlined in Appendix J to Volume 4 the form that such a tax could take".

If the first approach were adopted, it would mean that all low income, middle income and high income taxpayers would have to foot the bill in order to pay for the windfall that would accrue to high income shareholders.

If the second approach were adopted, the suggested special transition tax would be imposed on shareholders to raise the necessary revenue in the

transitional period to offset in part the initial revenue cost of integration. I am of the opinion that this tax would be discriminatory, as it would be levied on shareholders of corporations having large surpluses, whereas no tax would be paid by shareholders of new corporations or corporations having no accumulated surpluses. Shareholders of the former corporations would be induced to sell their shares and acquire shares of the latter kind of corporation in order to avoid the payment of the special transition tax.

I feel that what should be considered to prevent such a windfall to wealthy shareholders and to maintain the government's revenues is not to adopt the principle of full integration but instead to adopt the modified proposals of the Committee of Four hereinafter described.

Chapter 19, of the Report contains an evaluation of the proposals for the taxation of corporations presented by the Committee of Four. Recommendation 13 of this chapter states that the Committee-of-Four proposal, as modified in the briefs submitted to the Commission by the Canadian Institute of Chartered Accountants and the Canadian Bar Association, was carefully considered and rejected.

On October 1, 1960, a Special Committee on Corporate Taxation was appointed pursuant to Order in Council P.C. 1960-1356, to advise on certain problems connected with corporate taxation which were set forth in detail in the terms of reference mentioned in the report of the members of the said Special Committee, dated March 21, 1961. The report is available to the public and is summarized below so that I feel that it is unnecessary to reproduce it as an appendix to my report.

In December 1963, the Canadian Institute of Chartered Accountants presented a brief to this Commission referring to the report of the Special Committee in the following terms (p. 31):

"Subsequent to our Committee's formulation, of the above solution, the report of a Special Committee appointed in 1960 by the Minister of Finance to study corporate taxation, was released. The findings of that Special Committee and the results of our studies are quite similar. Although the Special Committee's proposal would appear to leave certain loopholes unattended it is generally in accord with the foregoing approach to solving the problem..."

In January 1964, the Canadian Bar Association presented a brief to this Commission which referred to the report of the Special Committee in the following terms (page 58):

"This Association has considered the Report of the Special Committee appointed by the Minister of Finance in 1960 to examine this problem. We agree with the Committee that an entirely new approach should be adopted in the taxation of corporate surpluses based on the acceptance of the principle of a flat withholding tax on all dividends. While the imposition of tax on dividends at a flat rate may appear inconsistent with the taxation of personal incomes at graduated rates, it may encourage investment in Canadian equities and it prevents discrimination against residents of Canada in favour of non-residents who are taxed on Canadian dividends at flat rates. Furthermore, the taxation of corporate distributions at a flat rate seems to be the only practical method of which we are aware by which the present problems of tax avoidance can be eliminated under the present system of taxing corporate and personal incomes.

This Association substantially adopts the recommendations of the Special Committee subject, however, to certain modifications which are indicated below.

The Association therefore RECOMMENDS:

1. That the present method of taxing dividends from Canadian resident taxable corporations be completely abolished and be replaced by a flat withholding tax of 15% on all dividends paid, or deemed to have been paid, except dividends paid to a parent Company by a subsidiary out of the latter's earnings while it was a subsidiary.

2. That inter-corporate dividends, other than those by a parent to a subsidiary, as indicated in 1. above, be subject to the said 15% withholding tax but redistribution of amounts equal to the net dividends received by the recipient corporation be not subject to any further tax.

3. That except as indicated in 1. and 2. above, the 15% withholding tax apply to all recipients of dividends from Canadian taxable corporations, including so-called deemed dividends, and that no exception or refund be made for individuals who now pay no tax as a result of the operation of the 20% dividend tax credit; and further that there be no additional tax by way of surtax or otherwise over and above the 15% withholding tax.

(This recommendation differs from the Special Committee suggestion concerning refund or tax credit, in respect of the 15% shareholders' tax, to Canadian resident individuals with incomes not exceeding $10,000 or enjoying the 20% tax credit.)

4. That s. 67 and s. 68 of the Income Tax Act relating to personal corporations be repealed".

As can be seen, very serious study of this problem has been made, not in the depth as that made by the staff of this Commission. However, it appears that the conclusions reached by the above two bodies are quite similar to those of the Committee of Four.

Therefore, my suggestion is that the recommendations of the report of the Committee of Four as modified by the suggestions in the briefs submitted by the Canadian Institute of Chartered Accountants and the Canadian Bar Association be seriously considered as an alternative to the recommendations in the Report in connection with the taxation of corporation profits and surplus distributions.

These recommendations are summarized as follows:

1. The basic recommendation is to impose, in lieu of the present method of taxation of dividends, a flat Shareholders Tax of 15% to be withheld by the corporation on any distribution or deemed distribution of accumulated corporate earnings to all shareholders by Canadian taxable corporations (hereinafter called "Canadian dividends").

   All dividends received from a taxable Canadian corporation by another taxable Canadian corporation would be considered exempt income as at present but would nevertheless be subject to the 15% withholding tax. These dividends would become a tax-paid undistributed income of the receiving company.

   Dividends paid by a corporation having such tax-paid undistributed income on hand would be deemed to be paid out of such undistributed income and to this extent would not be subject to further withholding.

2. In order to recognize the present favourable tax treatment accorded to Canadian resident individual shareholders with taxable incomes up to $10,000, a refund of the 15% Shareholders Tax would be granted to such individuals.

3. On shareholders' loans deemed to be a dividend, the corporation would be liable for a 15% withholding tax. (In effect, 15/85 of the deemed dividend). The tax paid by a corporation in these circumstances would become additional debt of the shareholder. On subsequent repayment of the loan, the 15% tax paid would be refundable.

4. With respect to a benefit conferred on a shareholder or an appropriation of property for the benefit of a shareholder, that is deemed a dividend (e.g., under section 81), the company would be liable for the 15% withholding tax (in effect, 15/85 of the deemed dividend).

5. Shareholders exempt from income tax by reason of the application of section 62 would be entitled to claim a refund of the 15% tax withheld from dividend income provided that the said shareholder (either alone or together with other shareholders with whom he does not deal at arm's length) does not own more than 10% of the equity stock of the dividend-paying corporation for which the claim is being made.

6. Mergers and amalgamations, however accomplished, would be subject to the payment of the 15% withholding tax on the grossed-up value (amount of distribution plus tax) of any undistributed income effectively distributed or converted into redeemable securities or debt through the merger or amalgamation.

7. The Designated Surplus provisions in section 28 and the special taxes in sections 47(4), 105, 105A, 105B and 105C, would be repealed and section 81, dealing with distributions by way of "deemed dividends" would be amended to include the provisions of present section 8 and to cover devices for "disappearance" of surpluses that may remain.

8. Transitional provisions will be necessary to preserve for a reasonable time all present rights respecting the distribution of existing surpluses tax free to corporate shareholders.

9. The provisions respecting personal corporations would be repealed.

The Committee of Four proposed a 15 per cent tax on dividends while the Report suggests that no tax be paid thereon. Therefore, how can one conclude that the Committee's suggestion substitutes a flat-rate tax for a progressive tax borne by the individual shareholder? Because the shareholder, while calculating the tax on income from corporate distributions or allocations at progressive rates, would receive full credit for the tax paid by the corporation at a flat rate. At least if the Committee's recommendation was adopted, the government would collect an appreciable amount of revenue that would not have to be collected from other sources.

There is no doubt that the benefit which would be granted to wealthy shareholders would be offset to a certain extent by the proposed tax on capital gains, and by the proposed tax on gains deemed to be realized at death if any, but at first glance, it looks nevertheless like a windfall for wealthy shareholders.

Appendix N to Volume 4 shows a comparison of taxes on comprehensive base income from shares for tax units with different characteristics under the Report's proposals and the proposals of the Committee of Four with taxation of gains on shares at half rates. Table N-1 shows a comparison of total (corporation and personal) taxes under the Report's proposals and the modified proposals of the Committee of Four for a family with two children with a comprehensive tax base income of $10,000 derived exclusively from corporate shares in a typical public company. Table N-2 provides a similar comparison for a family with two children with a comprehensive

tax base income of $100,000 derived exclusively from corporate shares in a typical private company.

First, of all, under the proposals in the Report the corporation tax paid would benefit resident shareholders as it could be applied against the tax liabilities of the resident tax unit—this is the comprehensive tax base which is recommended and to which I object.

Goodwill gains are defined as another increment in share value attributable to improved prospects for earnings. In the examples given, the tax liabilities are computed as though such gains were realized annually. Moreover, it has been assumed that goodwill gains are equal to cash dividends. For private companies it is assumed that their goodwill gains are only one half of those of public companies.

All of the comparisons given are based upon the assumption that the full corporation tax is borne by the shareholders.

In appraising the comparisons given in Tables N-1 and N-2, it should be noted that the examples show a complete distribution of after-tax earnings under the Report's proposals while a limited distribution is shown under the Committee-of-Four proposals. However, note (e) to these tables gives the results where 100 per cent of earnings is distributed in the case of the Committee-of-Four proposals.

In order to provide additional comparisons of the consequences of taxing corporations in various ways, I have prepared a set of tables hereto annexed and which show, among other things, the shareholder's receipts and the government's receipts under a variety of circumstances, calculation of taxes (personal and corporation) under the present system, under the Report's proposals and under the modified proposals of the Committee of Four are shown for a family with two children.

Tables A and B - with an income derived exclusively from shares in a company, including realized goodwill or capital gains of $2,019.15.

Tables C and D - with an income of $100,000 derived exclusively from shares in a company, including realized goodwill or capital gains of $13,978.49.

Tables E and F - with an income of $86,021.51 ($100,000 less capital gains of $13,978.49) derived exclusively from dividends and the allocated balance of earnings from a company.

Tables G and H - with an income of $200,000 derived exclusively from shares in a company, including realized goodwill or capital gains of $40,384.

Tables I and J - with an income of $159,616 ($200,000 less capital gains of $40,384) derived exclusively from dividends and the allocated balance of earnings from a company.

At the $10,000 level

The shareholder would benefit by a modest $468 under the Report's proposals while he would lose $2,194 under the Committee-of-Four proposals as a result of the corporate rate of tax of 21 per cent being eliminated and instead calculated at 50 per cent. Therefore, this increase would not be due to the Committee-of-Four proposals. Should the dual rate of corporation tax be unchanged, there would be no decrease in the shareholder's receipts.

The government's receipts would decrease by $348 under the Report's proposals, but would increase by $2,315 under the Committee-of-Four proposals due to the elimination of the dual rate of corporation tax.

At the $100,000 level

1. Assuming realized goodwill or capital gains of $13,978.49.

The shareholder would benefit by an increase of $5,588 under the Report's proposals, being an increase of 10 per cent in his net receipts although his income from realized capital gains would be taxed. On the other hand, under the Committee-of-Four proposals, his net receipts would decrease by $6,014 reflecting the tax he would have to pay on his capital gains and the decrease in dividends and allocated earnings resulting from the special tax of 15 per cent on dividend distributions.

But the government's receipts would increase by $6,014 due to the elimination of the dual rate of corporation tax and not to the Committee-of-Four proposals.

2. Assuming no realized goodwill or capital gains.

The windfall would be more apparent. The shareholder would have an increase of $12,438 in his receipts under the Report's proposals or 29 per cent, while under the Committee-of-Four proposals this increase would only be $5,310 or 12 per cent. The government's receipts would decrease by $12,438 or 28 per cent under the Report's proposals and increase by $5,310 or 12 per cent under the Committee-of-Four proposals entirely due to the elimination of the dual rate of corporation tax and not due to the Committee-of-Four proposals.

At the $200,000 level

1. Assuming realized goodwill or capital gains of $40,384.

The shareholder's receipts would increase by $6,628 under the Report's proposals being an increase of 6 per cent in his receipts although his income from realized capital gains would be taxed. On the other hand, under the Committee-of-Four proposals, his

receipts would decrease by a modest $493 due to the fact that only 50 per cent of his capital gains would be taxed at progressive rates.

The government's receipts would drop by $6,628 or 7 per cent under the Report's proposals, and would increase by $493 under the Committee-of-Four proposals.

2. Assuming no realized goodwill or capital gains.

The windfall to the shareholder would be quite significant. His receipts would be increased by $26,820 or 41 per cent under the Report's proposals while under the Committee-of-Four proposals, his receipts would be increased by $3,413 or 5 per cent.

The government's receipts would suffer a sharp drop of $26,820 or 28 per cent under the Report's proposals while the decrease under the Committee-of-Four proposals would be $3,413 or 3.6 per cent.

Therefore, it would seem that even with the taxation of realized goodwill or capital gains at full progressive rates, the shareholder would benefit from integration at the expense of the government's receipts.

It should be noted that under the modified proposals of the Committee of Four, the income taxes paid by the corporation appear to be higher, but it must be remembered that the 15 per cent withholding tax is paid in fact by reducing the amount allocated or paid to the shareholder, therefore, the corporation's cash flow is not decreased in doing so. It is true that the shareholder will receive less cash but having no further tax to pay he will be better off.

Let us examine an example of a corporation earning $1,000 and paying income tax at the rate of 50 per cent.

	Present System	Modified Committee-of-Four Proposals
Corporation level		
Earnings	$1,000	$1,000
Tax	500	500
	$ 500	$ 500
Withholding	n/a	75
	$ 500	$ 425
Dividend	500	425

Shareholder level

Let us assume that its shareholder pays a top 40 per cent rate.

	Present System	Modified Committee-of-Four Proposals
Dividend received	$ 500	$ 425
Tax	$ 200	
Less: Dividend tax credit 20 per cent	100	
Net Tax	$ 100	
Cash left	$ 400	$ 425

Thus, the cash paid by the corporation is the same and the shareholder would benefit by $25.

Note: The above figures and the figures shown in my Tables A to J do not reflect the increase in the maximum old age security tax as proposed in the Mini-Budget presented to Parliament by the Minister of Finance on December 19, 1966.

From the above observations, I would suggest that serious consideration be given to studying the alternative of adopting the modified Committee-of Four proposals instead of the Report's proposals of full integration. The benefit which would be granted to wealthy shareholders would be offset to a certain extent by the tax on capital gains, and by the tax on gains deemed to be realized at death if any, but I repeat that at first glance, it looks like a windfall for wealthy shareholders.

The Report also says: "Another difference is that our proposal would make holding Canadian equities more attractive to low and middle income resident individuals and less attractive to upper income resident individuals".

I cannot agree with this reasoning because it seems to me that funds from sales of Canadian equities are certainly more likely to be obtained from upper income resident individuals than from lower income resident individuals.

TABLE A

A COMPARISON WITH TABLE N-1 OF APPENDIX N TO VOLUME 4 OF THE REPORT

Calculation of Taxes (Personal and Corporation) Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four for a Family with Two Children with an Income of $10,000 Derived Exclusively from Shares in a Company, Including Realized Goodwill or Capital Gains of $2,019.15

	Present System		Report's Proposals		Committee-of-Four Proposals	
	Personal	Corporation	Personal	Corporation	Personal	Corporation
	$	$	$	$	$	$
Earnings		7,980.85		7,980.85		7,980.85
Income Tax		(1,675.98)		(3,990.43)		(3,990.43)
Dividends	2,019.15	(2,019.15)	2,019.15	(2,019.15)	1,716.28	(1,716.28)
Allocated balance of earnings	4,285.72	(4,285.72)	1,971.27	(1,971.27)	1,675.58	(1,675.58)
Additional tax on corporate distribution - 15%						(598.56)
Grossing-up						
Dividends			2,019.15			
Allocated balance of earnings			1,971.28			
Realized goodwill or capital gains	2,019.15		2,019.15		2,019.15	
	8,324.02	nil	10,000.00	nil	5,411.01	nil
Non-taxable	2,019.15				4,401.43	
	6,304.87		10,000.00		1,009.58	
Exemptions	2,600.00					
Family allowances			144.00		144.00	
	3,704.87		10,144.00		1,153.58	
Standard deduction	100.00		50.00		50.00	
Net tax base	3,604.87		10,094.00		1,103.58	
Gross tax (before credits)	634.93		1,487.68		nil	
Non-refundable tax credits for dependants			160.00		160.00	
	634.93		1,327.68		nil	
20% dividend tax credit	1,260.97					
Refundable credits on						
corporation taxes			3,990.43			
corporate distribution					598.56	
Total tax or refund	120.00	1,675.98	(2,662.75)	3,990.43	(598.56)	4,588.99
Total taxes	1,795.98		1,327.68		3,990.43	

Notes:

a/ In all three cases, I have assumed that all earnings after taxes were distributed.

b/ Under the Report's proposals and Committee-of-Four proposals, I have assumed that the dual rate of corporation income tax was abolished and that a standard rate of 50 per cent was adopted.

c/ Under the present system it is assumed that the corporation had income of under $35,000 and that therefore a corporation income tax rate of 21 per cent would be applicable. This is in contrast to the example in Table N-1 that concerns a typical public company and uses an average corporation income tax rate of 49.4 per cent.

d/ Under the Committee-of-Four proposals I have assumed that realized goodwill or capital gains were taxable on the same basis as under the United States Internal Revenue Code, namely, that 50 per cent of the gains were taxable at normal progressive rates, with a maximum rate of 50 per cent.

e/ I have assumed that the Report's recommendations regarding the taxation of family allowances, the standard deduction and the non-refundable credits for dependants were adopted.

f/ Under the present system, the personal tax is $120 as the dividend tax credit does not reduce the old age security tax payable.

TABLE B

Statement Showing the Distribution of a Total Income of $10,000 Between a Shareholder and the Government Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four, as Detailed in Table A

	Present System	Report's Proposals	Committee-of-Four Proposals
	$	$	$
Shareholder's receipts			
Dividends	2,019.15	2,019.15	1,716.28
Allocated balance of earnings	4,285.72	1,971.27	1,675.58
Realized goodwill or capital gains	2,019.15	2,019.15	2,019.15
	8,324.02	6,009.57	5,411.01
Less: Personal tax	120.00		
Add: Tax refund		2,662.75	598.56
	8,204.02	8,672.32	6,009.57
Government's receipts	1,795.98	1,327.68	3,990.43
	10,000.00	10,000.00	10,000.00

TABLE C

A COMPARISON WITH TABLE N-2 OF APPENDIX N TO VOLUME 4 OF THE REPORT

Calculation of Taxes (Personal and Corporation) Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four for a Family with Two Children with an Income of $100,000 Derived Exclusively from Shares in a Company, Including Realized Goodwill or Capital Gains of $13,978.49

	Present System		Report's Proposals		Committee-of-Four Proposals	
	Personal $	Corporation $	Personal $	Corporation $	Personal $	Corporation $
arnings		86,021.51		86,021.51		86,021.51
Income tax		(32,860.75)		(43,010.76)		(43,010.76)
Dividends	27,956.99	(27,956.99)	27,956.99	(27,956.99)	23,763.44	(23,763.44)
Allocated balance of earnings	25,203.77	(25,203.77)	15,053.76	(15,053.76)	12,795.70	(12,795.70)
Additional tax on corporate distributions - 15%						(6,451.61)
Grossing-up						
Dividends			27,956.99			
Allocated balance of earnings			15,053.77			
Realized goodwill or capital gains	13,978.49		13,978.49		13,978.49	
	67,139.25	nil	100,000.00	nil	50,537.63	nil
Non-taxable	13,978.49				43,548.39	
	53,160.76		100,000.00		6,989.24	
Exemptions	2,600.00					
Family allowances			144.00		144.00	
	50,560.76		100,144.00		7,133.24	
Standard deduction	100.00		50.00		50.00	
Net tax base	50,460.76		100,094.00		7,083.24	
Gross tax (before credits)	21,923.42		38,724.00		863.65	
Non-refundable tax credits for dependants			160.00		160.00	
	21,923.42		38,564.00		703.65	
20% dividend tax credit	10,632.15					
Refundable credits on corporation taxes			43,010.76			
Total tax (or refund)	11,291.27	32,860.75	(4,446.76)	43,010.76	703.65	49,462.37
Total taxes	44,152.02		38,564.00		50,166.02	

Notes:

a/ In all three cases, I have assumed that all earnings after taxes were distributed.

b/ Under the Report's proposals and Committee-of-Four proposals, I have assumed that the dual rate of corporation income tax was abolished and that a standard rate of 50 per cent was adopted.

c/ Under the present system it is assumed that all of the income of the corporation was attributable to this one shareholder, so that the $86,021.51 of corporation income would be subject to corporation tax of 21 per cent on the first $35,000 and 50 per cent on the balance. This is in contrast to the example in Table N-2 that concerns a typical private company and uses an average corporation income tax rate of 35 per cent.

d/ Under the Committee-of-Four proposals I have assumed that realized goodwill or capital gains were taxable on the same basis as under the United States Internal Revenue Code, namely, that 50 per cent of the gains were taxable at normal progressive rates with a maximum rate of 50 per cent.

e/ I have assumed that the Report's recommendations regarding the taxation of family allowances, the standard deduction and the non-refundable credits for dependants were adopted.

f/ Under the present system, the personal tax is $120 as the dividend tax credit does not reduce the old age security tax payable.

TABLE D

Statement Showing the Distribution of Total Income of $100,000 Between a Shareholder and the Government Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four, as Detailed in Table C

	Present System	Report's Proposals	Committee-of-Four Proposals
	$	$	$
Shareholder's receipts			
Dividends	27,956.99	27,956.99	23,763.44
Allocated balance of earnings	25,203.77	15,053.76	12,795.70
Realized goodwill or Capital gains	13,978.49	13,978.49	13,978.49
	67,139.25	56,989.24	50,537.63
Less: Personal tax	11,291.27		703.65
Add: Tax refund		4,446.76	
	55,847.98	61,436.00	49,833.98
Government's receipts	44,152.02	38,564.00	50,166.02
	100,000.00	100,000.00	100,000.00

TABLE E

A COMPARISON WITH TABLE N-2 OF APPENDIX N TO VOLUME 4 OF THE REPORT WITHOUT REALIZED GOODWILL GAINS

Calculation of Taxes (Personal and Corporation) Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four for a Family with Two Children with an Income of $86,021.51 Derived Exclusively from Dividends and Allocated Balance of Earnings from a Company

	Present System		Report's Proposals		Committee-of-Four Proposals	
	Personal	Corporation	Personal	Corporation	Personal	Corporation
	$	$	$	$	$	$
Earnings		86,021.51		86,021.51		86,021.51
Income tax		(32,860.75)		(43,010.76)		(43,010.76)
Dividends	27,956.99	(27,956.99)	27,956.99	(27,956.99)	23,763.44	(23,763.44)
Allocated balance of earnings	25,203.77	(25,203.77)	15,053.76	(15,053.76)	12,795.70	(12,795.70)
Additional tax on corporate distribution - 15%						(6,451.61)
Grossing-up						
Dividends			27,956.99			
Allocated balance of earnings			15,053.77			
	53,160.76	nil	86,021.51	nil	36,559.14	nil
Non-taxable					36,559.14	
	53,160.76		86,021.51		nil	
Exemptions	2,600.00					
Family allowances			144.00		144.00	
	50,560.76		86,165.51		144.00	
Standard deduction	100.00		50.00		50.00	
Net tax base	50,460.76		86,115.51		94.00	
Gross tax (before credits)	21,923.42		31,873.60		nil	
Non-refundable tax credits for dependants			160.00		160.00	
	21,923.42		31,713.60		nil	
20% dividend tax credit	10,632.15					
Refundable credits on corporation taxes			43,010.76			
Total tax (or refund)	11,291.27	32,860.75	(11,297.16)	43,010.76	nil	49,462.37
Total taxes	44,152.02		31,713.60		49,462.37	

Notes:

a/ In all three cases, I have assumed that all earnings after taxes were distributed.

b/ Under the Report's proposals and Committee-of-Four proposals, I have assumed that the dual rate of corporation income tax was abolished and that a standard rate of 50 per cent was adopted.

c/ Under the present system it is assumed that all of the income of the corporation was attributable to this one shareholder, so that the $86,021.51 of corporation income would be subject to corporation tax of 21 per cent on the first $35,000 and 50 per cent on the balance. This is in contrast to the example in Table N-2 that concerns a typical private company and uses an average corporation income tax rate of 35 per cent.

d/ Under the Committee-of-Four proposals I have assumed that realized goodwill or capital gains were taxable on the same basis as under the United States Internal Revenue Code, namely, that 50 per cent of the gains were taxable at normal progressive rates, with a maximum rate of 50 per cent.

e/ I have assumed that the Report's recommendations regarding the taxation of family allowances, the standard deduction and the non-refundable credits for dependants were adopted.

f/ Under the present system, the personal tax is $120 as the dividend tax credit does not reduce the old age security tax payable.

TABLE F

Statement Showing the Distribution of Total Income of $86,021.51 Between a Shareholder and the Government Under the Present System, Under the Report's Proposals, and Under the Modified Proposals of the Committee of Four, as Detailed in Table E

	Present System	Report's Proposals	Committee-of-Four Proposals
	$	$	$
Shareholder's receipts			
Dividends	27,956.99	27,956.99	23,763.44
Allocated balance of earnings	25,203.77	15,053.76	12,795.70
	53,160.76	43,010.75	36,559.14
Less: Personal tax	11,291.27		
Add: Tax refund	———	11,297.16	———
	41,869.49	54,307.91	36,559.14
Government's receipts	44,152.02	31,713.60	49,462.37
	86,021.51	86,021.51	86,021.51

TABLE G

Calculation of Taxes (Personal and Corporation) Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four for a Family with Two Children with an Income of $200,000 Derived Exclusively from Shares in a Company, Including Realized Goodwill or Capital Gains of $40,384

	Present System		Report's Proposals		Committee-of-Four Proposals	
	Personal	Corporation	Personal	Corporation	Personal	Corporation
	$	$	$	$	$	$
Earnings		159,616		159,616		159,616
Income tax		(69.658)		(79,808)		(79,808)
Dividends	40,383	(40,383)	40,383	(40,383)	34,326	(34,326)
Allocated balance of earnings	49,575	(49,575)	39,425	(39,425)	33,511	(33,511)
Additional tax on corporate distribution - 15%						(11,971)
Grossing-up						
Dividends			40,383			
Allocated balance of earnings			39,425			
Realized goodwill gains	40,384		40,384		40,384	
	130,342	nil	200,000	nil	108,221	nil
Non-taxable	40,384				88,029	
	89,958				20,192	
Exemptions	2,600					
Family allowances			144		144	
	87,358		200,144		20,336	
Standard deduction	100		50		50	
Net tax base	87,258		200,094		20,286	
Gross tax (before credits)	43,525		88,724		4,066	
Non-refundable tax credits for dependants	n/a		160		160	
	43,525		88,564		3,906	
20% dividend tax credit	17,991					
Refundable credits on corporate distributions			79,808			
Total tax	25,534	69,658	8,756	79,808	3,906	91,779
Total taxes	95,192		88,564		95,685	

Notes:

a/ In all three cases, I have assumed that all earnings after taxes were distributed.

b/ Under the Report's proposals and Committee-of-Four proposals, I have assumed that the dual rate of corporation income tax was abolished and that a standard rate of 50 per cent was adopted.

c/ Under the present system it is assumed that all of the income of the corporation was attributable to this one shareholder, so that the $159,616 of corporation income would be subject to corporation tax of 21 per cent on the first $35,000 and 50 per cent on the balance. This is in contrast to the example in Table N-2 that concerns a typical private company and uses an average corporation income tax rate of 35 per cent.

d/ Under the Committee-of-Four proposals I have assumed that realized goodwill or capital gains were taxable on the same basis as under the United States Internal Revenue Code, namely, that 50 per cent of the gains were taxable at normal progressive rates, with a maximum rate of 50 per cent.

e/ I have assumed that the Report's recommendations regarding the taxation of family allowances, the standard deduction and the non-refundable credits for dependants were adopted.

f/ Under the present system, the personal tax is $120 as the dividend tax credit does not reduce the old age security tax payable.

TABLE H

Statement Showing the Distribution of Total Income of $200,000 Between a Shareholder and the Government Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four, as Detailed in Table G

	Present System	Report's Proposals	Committee-of-Four Proposals
	$	$	$
Shareholder's receipts			
Dividends	40,383	40,383	34,326
Allocated balance of earnings	49,575	39,425	33,511
Realized goodwill or capital gains	40,384	40,384	40,384
	130,342	120,192	108,221
Less: Personal tax	25,534	8,756	3,906
	104,808	111,436	104,315
Government's receipts	95,192	88,564	95,685
	200,000	200,000	200,000

TABLE I

Calculation of Taxes (Personal and Corporation) Under the Present System, Under the Report's Proposals, and Under the Modified Proposals of the Committee of Four for a Family with **Two** Children with an Income of $159,616 Derived Exclusively from Dividends and Allocated Balance of Earnings from a Company

	Present System		Report's Proposals		Committee-of-Four Proposals	
	Personal	Corporation	Personal	Corporation	Personal	Corporation
	$	$	$	$	$	$
Earnings		159,616		159,616		159,616
Income tax		(69,658)		(79,808)		(79,808)
Dividends	40,383	(40,383)	40,383	(40,383)	34,326	(34,326)
Allocated balance of earnings	49,575	(49,575)	39,425	(39,425)	33,511	(33,511)
Additional tax on corporate distribution - 15%						(11,971)
Grossing-up						
Dividends			40,383			
Allocated balance of earnings			39,425			
	89,958	nil	159,616	nil	67,837	nil
Non-taxable					67,837	
Exemptions	2,600					
Family allowances			144		144	
	87,358		159,760		144	
Standard deduction	100		50		50	
Net tax base	87,258		159,710		94	
Gross tax (before credits)	43,525		68,532		nil	
Non-refundable tax credits for dependants	n/a		160		160	
	43,525		68,372			
20% dividend tax **credit**	17,991					
Refundable credits on corporate distributions			79,808			
Total tax	25,534	69,658	(11,436)	79,808	nil	91,779
Total taxes	95,192		68,372		91,779	

Notes:

a/ In all three cases, I have assumed that all earnings after taxes were distributed.

b/ Under the Report's proposals and Committee-of-Four proposals, I have assumed that the dual rate of corporation income tax was abolished and that a standard rate of 50 per cent was adopted.

c/ Under the present system it is assumed that all of the income of the corporation was attributable to this one shareholder, so that the $159,616 of corporation income would be subject to corporation tax of 21 per cent on the first $35,000 and 50 per cent on the balance. This is in contrast to the example in Table N-2 that concerns a typical private company and uses an average corporation income tax rate of 35 per cent.

d/ Under the Committee-of-Four proposals I have assumed that realized goodwill or capital gains were taxable on the same basis as under the United States Internal Revenue Code, namely, that 50 per cent of the gains were taxable at normal progressive rates with a maximum rate of 50 per cent.

e/ I have assumed that the Report's recommendations regarding the taxation of family allowances, the standard deduction and the non-refundable credits for dependants were adopted.

f/ Under the present system, the personal tax is $120 as the dividend tax credit does not reduce the old age security tax payable.

TABLE J

Statement Showing the Distribution of Total Income of $159,616 Between a Shareholder and the Government Under the Present System, Under the Report's Proposals and Under the Modified Proposals of the Committee of Four, as Detailed in Table I

	Present System	Report's Proposals	Committee-of-Four Proposals
	$	$	$
Shareholder's receipts			
Dividends	40,383	40,383	34,326
Allocated balance of earnings	49,575	39,425	33,511
	89,958	79,808	67,837
Less: Personal tax	25,534		
Add : Tax refund	—	11,436	—
	64,424	91,244	67,837
Government's receipts	95,192	68,372	91,779
	159,616	159,616	159,616

CHAPTER 20

MUTUAL ORGANIZATIONS AND TAX-EXEMPT ENTITIES

It is recommended in the Report that certain non-profit organizations, including agricultural organizations, professional organizations, boards of trade, chambers of commerce and labour organizations, should be taxed at the corporation income tax rate on the undistributed income from non-portfolio investment. Their undistributed portfolio income should be exempt from the corporation income tax, but should be subject to a postponement fee of, say, 15 per cent.

I object to this recommendation and am of the opinion that no postponement fee should be payable. If this income is exempt from corporation income tax, the proceeds might be used to pay for fixed assets and never be distributed, and I do not see why a postponement fee should be paid.

CHAPTER 22

GENERAL BUSINESS INCOME

Under the present capital cost allowance system, proceeds in excess of the original cost of a depreciable asset are not taxable. They are considered a capital gain. The Report says: "In accordance with our recommendation for a comprehensive tax base, the proceeds from disposal of a depreciable asset in excess of its original cost should be taxable". I have stated my views on the taxing of capital gains, namely, that they should be taxed, based on the same pattern as presently adopted by the United States Internal Revenue Code, namely, on an amount equivalent to 50 per cent of the gain taxable at progressive rates but at a maximum rate of 50 per cent. The same reasoning applies to the taxation of goodwill gains.

"6. Any element of personal benefit in business expenditures may generally be allowed in arriving at business income, but should be reported as income of the recipient. If such allocation to the recipient is not possible, the business should be subject to a special tax on such personal

benefits on their grossed-up amount at the top personal rate, and this special tax should be allowed as a deduction."

I am opposed to this recommendation which I find very arbitrary and inequitable.

CHAPTER 25

OTHER INDUSTRIES

FORESTRY

Taxes on logging income paid to provincial governments are deductible as a tax credit. The lesser of two thirds of the provincial logging tax or 6-2/3 per cent of the taxpayer's logging income in the province is permitted as a deduction against federal income tax, and one third of the provincial logging tax is permitted as a deduction against provincial tax in Ontario and Quebec, and 18 per cent against provincial tax in British Columbia.

The Report recommends that provincial logging taxes should be deductible from taxable income as an expense and should not be claimed as a tax credit from federal tax otherwise payable. I am of the opinion that this tax is a mere shifting from federal to provincial taxes in its totality in so far as Ontario and Quebec are concerned and in part for British Columbia. Therefore, I recommend that the present treatment of this tax remain unchanged.

The Report says that any gain on disposal of timber properties should be included in income in the same manner as gains on disposal of other types of property. I repeat my own recommendation that this should be considered as a capital gain and taxed in the manner I have already described.

Respectfully submitted,

A. Emile Beauvais

A. EMILE BEAUVAIS, C.A.
Commissioner

APPENDIX TO THE MINORITY REPORT
OF COMMISSIONER BEAUVAIS

EXTRACT FROM CANADIAN TAX JOURNAL
VOLUME XIII, NO. 5—SEPTEMBER-OCTOBER 1965

CAPITAL GAINS TAX

Capital Gains—to Tax or Not to Tax

by Ronald Robertson

> "Few areas of tax policy evoke such strong opinions as that of the taxation of capital gains. This summary attempts to outline as briefly as possible the pros and cons, and to draw attention to what may be considered weaknesses in some of the main points on each side. This note grew out of discussions at several tax meetings in which the Director has participated in recent months."

Current Canadian interest in the question of whether capital gains should be taxed stems from two sources: the strong possibility that the Royal Commission on Taxation may find it appropriate to recommend their inclusion in the tax base, and the recent extension of the tax in Great Britain. The arguments pro and con vary in importance with one's point of view and, perhaps, one's own expectation of ever personally making a capital gain. The arguments criss-cross through considerations of economics, equity, administrative feasibility, law, accounting, business and revenue raising, creating a rather muddled assembly. Many of the arguments on either side would require a book to do them justice—however this listing may be useful as a starting point for taxpayers who wish to consider and do further reading on the subject while awaiting the tabling of the Royal Commission report.

The "Cons"

1. A capital gains tax would inhibit the flow of risk-taking capital investment which is essential for the development of a young and growing country like Canada. (In this connection, one of the points in the recent case—Valclair v. M.N.R., (64 DTC 5014), is worth considering. In examining the transaction, Mr. Justice Kearney noted that an undertaking involved risk or speculation. There was little risk involved for the taxpayer in Valclair (a purchase and subsequent sale of farm land outside Montreal) since the company had plenty of cash and could afford to "fold its arms and adopt a

safe and positive attitude". In finding that as a result, in part at least, of this lack of risk, the gain was not income but a capital gain, the courts in Canada have perhaps made the risk argument, in the case of land, rather academic.)

2. A closely related "Con" argument is that a tax on gains arising from the appreciation of corporate share values would probably have the effect of increasing shareholder pressures for the distribution of corporate earnings. This could result in less funds being available for reinvestment in business and the reduced corporate retentions would, in turn, have unfavourable effects on growth.

In a recent article, "Taxation on Capital Gains", National Tax Journal, June 1965, Henry C. Wallich, Professor of Economics at Yale and former Assistant to the U.S. Secretary of the Treasury (1958-59), argued that a "capital gains tax affects the supply of saving much more severely than would a true income tax of identical yield. A tax upon individual income reduces both saving and consumption, in the proportion in which individuals allocate their marginal income between the two. A capital gains tax, not being a tax upon what can properly be considered income, is paid very largely out of savings, or out of capital, which amounts to the same thing." In his review of the existing U.S. capital gains tax, Mr. Wallich concluded that "the principal adverse effect...is that on saving. The tax absorbs a not insignificant part of the annual supply of saving. For an economy trying to maximize its rate of growth, almost any other method of raising revenue would have less counter-productive effects."

3. The revenue yields would be negligible and in fact might result in revenue loss. The reasoning here is that, assuming a capital gains tax were imposed at a flat rate, the odds are that many borderline cases now caught at full income rates in Canada would soon get capital gains treatment at the lower rate. Critics also suggest that U.S. figures on capital gains collections have little relevance in Canada for this reason.

Further, if capital losses were allowed, it can be argued that they would largely offset gains. A similar point is that Canada's attractiveness to risk capital from countries where there is a tax on capital gains would be diminished. This in turn would result in Canada losing the tax payable on regular income from such investment as is lost.

4. A capital gains tax would result in such complicated legislation that the present tax laws would look like child's play by comparison. The U.S. experience, and more recently, the experience in Great Britain, tends to underline this point.

5. The tax is costly, to collect and, as a corollary to 4, a nightmare for taxpayers and revenue officials alike.

6. A capital gains tax would lead to more avoidance and evasion than we have now, and result in a lessened regard for our tax laws. (A recent study in the U.S. suggests that there is wide scale avoidance of the capital gains tax there. In an article in the June 1964, National Tax Journal, H. H. Hinrichs estimated that "as much as a third or more of individual taxpayers' capital gains appears to be unreported, at least in the securities field." However in a subsequent article in the same Journal this conclusion was disputed by critics who argued that there may, in fact, be over-reporting in the securities field in the U.S. (See "How to Succeed in Figuremanship Without Having all the Figures", Stan West and James W. Riley and " 'Altruism on Wall Street or Who's Afraid of the IRS'—A Reply to West and Riley" by H. H. Hinrichs in the National Tax Journal, March 1965.)

7. A capital gains tax gives no assurance of equity, but merely shifts the line. While in Great Britain, the stringent new tax provides for deemed realizations at death, in the case of gifts, and at 15 year intervals where settled property is involved, it is generally conceded that as a practical matter, with few exceptions, only realized gains can be taxed. This being so, the person who realizes his gains several times in a lifetime may suffer

a relatively heavier burden than a person who can hold on to his property. Another example of the argument that a capital gains tax gives no assurance of equity, is that when exclusions are permitted (such as profits from the sale of a personal residence) there will be inequity as between the person who puts his money into a home and the person who rents, and puts his capital into shares, bonds or other assets, the gains from which are taxed.

8. If a capital gains tax is exigible on death, and is followed by a death tax on the balance, a double tax bite is felt. As noted, this is the case with Great Britain's broadened capital gains tax. The Americans have discussed this point for years. A similar argument is that death taxes should be considered a once-in-a-lifetime capital gains tax and this should be sufficient for the purpose of equity.

9. The tax on long-term capital gains may be largely a tax on inflated values and not on real gains. Where a taxpayer has to replace an asset upon which a monetary gain has been realized he must buy at the inflated price. In effect, therefore, he suffers a capital rather than a capital gain tax. In some countries an allowance is made for inflation before tax is imposed.

Another side of the inflation argument was noted by J. Van Hoorn, Jr., managing director of the International Bureau of Fiscal Documentation, in a recent article in European Taxation (June, 1965). He recalled the argument that it is not only the prices of capital assets that become inflated over time. Inflation also hits wages and other forms of income which are subjected in most countries to graduated income tax rates.

10. Where time periods are introduced to distinguish between long-term and short-term capital gains, the market mechanism is impeded to the extent that people are "locked into" investments until a long-term gain taxable at lower rates may be realized. Conversely, where losses occur taxpayers may tend to sell investments prematurely in order to realize deductible short-term losses.

11. A capital gains tax at regular graduated rates is inequitable and virtually confiscatory where the gain has accrued over a period of years, but is taxed at a high marginal rate in one year.

12. Where capital gains are taxed at special rates, the need to distinguish between a capital gain and a regular income still exists.

It will be noted that several of these points concern the form as much as the existence of a capital gains tax. However, it seems highly unlikely, short of some sort of general averaging provision, that a capital gains tax can be devised against a background of graduated rates and not contain a number of inequitable and distorting side effects.

The "Pros"

1. There is no doubt about the main argument put forward in favour of taxing capital gains. It is that such a levy makes the tax system more equitable. The reasoning here is simply that a capital gain is as much income, in the economic sense of providing command over goods and services, as any other kind of receipt and the ability to pay concept requires its inclusion in the tax base. The same can, of course, be said for family allowances, unemployment insurance benefits, gifts and a wide variety of fringe and other benefits whether received in cash or in kind.

Professor Wallich, however, in the article referred to above, argued that capital gains are not always the equivalent of other types of income. He pointed out that "the only source of capital gains that produces income in the national accounting sense is the accumulation of retained profits of enterprise".

The equitable argument is usually illustrated with examples of the huge profits of land speculators or of stock market winnings. While there are exceptions, as in the case of _Valclair_ noted above, it may be suggested that in Canada at least, most land speculators have had a pretty rough time in the

courts in recent years and many of them might have preferred to have been hit by capital gains tax rather than by the full impact of graduated rates in one year.

One's passion for or against a tax on capital gains tends to vary with the facts and status of the person who received it. The farmer who makes a gain on the sale of his farm after a lifetime of toil seldom invokes the rancour which an economically similar gain will produce if it is realized by a city slicker in a year or two. However, capital gains come in all shades of equitable white, grey and black. (Those who find the equity argument appealing may wonder why in Great Britain while the pool itself is taxed, winnings from "pools" have been excluded from the capital gains levy. Some Britishers I have spoken with suspect that this is another case of tax "equity" being somewhat synonymous with party politics.)

2. This leads to the second argument, namely, that those who make capital gains might be better off with a capital gains tax than they are at present in Canada, since the legal capital gains-income line would probably soften, and more gains which are now taxed at full rates would get capital gains treatment. This seems to be what has happened in the United States.

3. It is also suggested that a capital gains tax would provide for greater certainty in the taxation of capital receipts. This, it can be argued, would enhance risk-taking rather than work against it.

4. If capital losses were allowed to offset capital gains, or preferably ordinary income, more risk capital would be forthcoming. In connection with this argument, however, it should be noted that many capital gains tax enthusiasts shy away from allowing capital losses against ordinary income. But if the main test is equity, and if equity means ability to pay, it is hard to see why capital losses should not be permitted to be offset against any other kind of income. In principle, at least, ability to pay should not be one-way street.

It may, of course, be difficult in many cases to distinguish between a capital loss and a decrease in value resulting from partial consumption of a capital asset. For assets subject to capital cost allowance the mechanism for allowance is already available in Canada under the Income Tax Act. But for personal property—a car for example—one would have to ask whether a difference between the purchase and sale prices, where the latter is lower, should be recorded as a capital loss and be deductible, or whether the difference represents partial consumption of the asset? It may not be possible to permit a deduction for all decreases in value; however, where a capital loss can be ascertained equity should be applicable in both directions.

5. The revenue from a capital gains tax is not as inconsiderable as suggested, (the contrary arguments might be recalled). Here the U.S. figures are usually cited. In the United States, tax revenues from the tax on capital gains amount to about 5% of the individual tax revenues. In 1959, the late Dr. Kenneth Eaton estimated the potential Canadian yield at that time as about $100 million a year.

6. With respect to business capital gains, it is argued that business exists to make a profit, and a profit is a profit whether in the form of a capital gain or not. In fact, there seems to be one school of thought among accountants that, under "generally accepted accounting principles", capital gains and losses should be reflected in the statement of earnings.

7. Inclusion of capital gains would widen the tax base and the revenue from a tax on capital gains should permit some lowering of the general tax rates—perhaps producing a trade-off between high personal income tax rates and a flat-rate on capital gains.

8. The taxing of capital gains would remove some of the impetus to strip corporate surplus. It is the magic of transforming undistributed income into tax-free capital receipts that provides the main "dividend stripping"

incentive. When the difference in tax consequence can be between zero and 80%, or even between zero and 15%, the attraction is quite strong.

9. It is the lack of a capital gains tax that induces some Canadians to sell out to American buyers. It can be argued that Americans buy and hold business interests because so far in the U.S. there is no capital gains tax on transfers at death. In Canada, on the other hand, it is sometimes argued that the absence of a capital gains tax may act, surprisingly, as an inducement for Canadians to sell out family companies and retire to a sunnier climate on the proceeds. That is, there is no benefit to be gained from holding on to assets until death in Canada while there is in the United States.

10. The administrative complexities are not so impossible as opponents suggest. The U.S. manages to impose a capital gains tax; so also do the United Kingdom and many other countries to various extents.

11. The United States experience is often cited as evidence that a capital gains tax does not inhibit risk-taking, for Americans are reputed to be among the greatest risk-takers in the world. There is, of course, the point that development and capital accumulations in the U.S. had progressed much further than in Canada before income taxes became important.

12. Canada will soon be an island surrounded by capital gains taxes and since others are imposing them, it must be right and fair so we should impose them too.

This very brief outline summarizes the arguments on each side; perhaps there are more. Those who are interested in weighing the various arguments will find many of them discussed in more detail in the <u>Report</u> of the Foundation's 1959 Annual Conference, where Dr. Eaton, former Assistant Deputy Minister of Finance, and Professor L. H. Seltzer debate the issue "Should Capital Gains be Taxed?" Professor Seltzer is the author of what many consider to be the definitive work on the subject. <u>The Nature and Tax Treatment of Capital Gains and Losses</u>, published in 1951. An excellent review

of the arguments and problems as viewed from Great Britain prior to introduction of capital gains tax there is to be found in The Taxation of Capital Gains, by Professor A. R. Ilersic published in 1962. The recent British capital gains tax is analyzed by Professor G.S.A. Wheatcroft in a new book entitled Capital Gains Tax.

For more on recent U.S. experience Professor Wallich's article can be commended as can the report of the U.S. Congressional Economic Committee, entitled The Federal Tax System: Facts and Problems 1964.

MINORITY REPORT - COMMISSIONER D. G. GRANT

It is with great regret that I find myself unable to agree with the majority of my fellow Commissioners on a limited number of the Report's recommendations. This is due principally to my inability to accept in its entirety the concept of income as contemplated by the comprehensive tax base and the wisdom of applying this concept to the tax system at this time. The Report maintains that taxation at progressive rates of all additions to economic power is the only equitable basis for taxation. Complete adoption of this principle in my opinion would destroy certain elements of our present system which should be retained. The Report in fact recognizes this, for it embodies some modifications of the comprehensive tax base in its treatment of deferring tax on certain forms of pensions, annuities, life interests and the proceeds of life insurance arising from a mortality gain or loss when paid to the insured or a member of his family unit. While subscribing to these variations, I would exclude other forms of income from the comprehensive tax base and include other variations.

BUSINESS LOSSES

The treatment of losses, and business losses in particular, is covered in Chapters 9, 15, and 22 of the Report. The present loss base is broadened to permit business losses to be applied against income from all sources over a period of two years preceding a year of loss and indefinitely thereafter. The Report places a limit, however, on charging such losses against other income by fixing an arbitrary rule that if three years' losses are sustained in a business within a five-year period, then subsequent losses would be deductible only from income of the same business and not from income from other sources. I support the view that no person wishes to conduct a business at a loss. If this is not always true, then the great majority of such business undertakings should not be placed under arbitrary restrictions to

block abuses of a relative few. Such a provision could dislocate established businesses, as in some cases it would cause an involuntary and premature closing with resultant unemployment. In addition—and this would perhaps be a more serious consequence—it would have a deterrent effect on the establishment of new businesses. To follow the Report in this instance would inhibit expansion and curtail initiative.

Under the present law, a loss from one source of income is deductible from income arising from all other sources in the same year, subject to the restriction in section 13 of the Income Tax Act. Under section 27(1)(e) of the Act, a business loss, to the extent that it is not deductible from other income in the year, may be carried back one year and forward five years as a deduction. It is deductible in that period to the extent of the income from any business and not only from the business in which the loss was sustained. Subsections (5) and (5a) of section 27 provide in effect that a loss incurred by a corporation can no longer be carried forward if the business in which the loss was sustained has been discontinued and the control of the corporation has changed. If there is no change in control, however, the loss can be carried forward in spite of the fact that the business has been discontinued.

Rather than accept the proposal with respect to losses as set forth in the Report, I would recommend that the present law be changed only to the extent of permitting the loss deductions to be carried back two years and forward indefinitely, with losses being deductible against all sources of income in the year of the loss and against business income over the balance of the loss period.

The Report deals at some length with section 13 of the Act, which limits the amount of losses which can be claimed when the taxpayer's chief source of income for a taxation year is neither farming nor a combination of farming and some other source of income. While the Report would repeal section 13 and thus remove this restriction and place such losses under the general

provisions for losses as recommended in the Report, I would retain the present limitation with respect to the deduction of such losses.

CAPITAL GAINS

Any introduction to the subject of taxing capital gains should recognize that this is not a new form of tax so far as Canada is concerned. The present Act brings into income for tax purposes all income from business and property, and "business" is defined in the Act as including "a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes an adventure or concern in the nature of trade". The Act does not define the term "capital gains" or, for that matter, the word "income".

The Report recommends that capital gains be included in the comprehensive tax base and taxed at full rates. The Report seeks to minimize the inequities which are undoubtedly involved in this departure from existing tax law by providing some ameliorating provisions, notably the lowering of the top individual tax rate, general averaging, full integration of corporation and individual tax rates and, finally, the deduction of capital losses from all forms of income by allowing the taxpayer to carry back such losses for two years and forward indefinitely. While the Report would tax gains realized on personal property, it would limit the deduction of losses to those incurred in the disposal of similar kinds of property within the preceding two years. These provisions, in my opinion, prove inadequate as compensatory measures to ease what must be regarded as stringent legislation.

But there are other reasons why capital gains should not be taxed at full rates. Capital investment of savings in Canada by Canadians is to be encouraged. Also it must be kept in mind that Canada's two principal trading partners, the United States and the United Kingdom, impose this form of tax at modified rates. Shares with growth potential have particular significance in a country such as Canada, and investment should not be inhibited by a high rate of tax on capital appreciation. The inflationary element is ever present

in gains in securities and real estate, and to tax capital gains that resulted from a general increase in price levels at full rates would be inequitable.

I am in favour of taxing capital gains—some at preferential rates and some at full rates—depending upon a time element and the nature of the undertaking. It is not suggested that bringing capital gains into tax at a preferential rate will remove the "grey" element which now exists, but imposing such a tax by reference to a time factor in taxing capital gains will add a degree of certainty which is now absent.

I propose, therefore, that all property gains realized within one year from the date of acquisition, and real estate gains realized within three years from the date of acquisition, should be taxed at the individual's marginal progressive rate or at the corporation's rate; with the provision, however, that land which has been expropriated within the three-year period would be exempt from capital gains tax if the owner acquired it without prior knowledge of expropriation and did not attempt to dispose of it prior to the expropriation, and if the proceeds after expropriation were reinvested in a similar way within a stated time. After the one- and three-year periods, tax would be imposed on the individual at one-half his marginal rate (and would not therefore exceed 25 per cent), or on corporations at the rate of 25 per cent. Losses would be deducted against capital gains in the year incurred, with a loss carry-back for one year and a carry-forward indefinitely against capital gains.

The "locked-in" consequences of a full-rate capital gains tax may have a serious effect on mobility of capital. A preferential rate should reduce this tendency, for, as the <u>Report</u> points out, a capital gains tax in the United States has had "very little overall effect on the level of aggregate investment". Furthermore, it is expected that full integration of corporation and personal income tax rates with a preferential rate on capital gains will counter what appears to be a natural reluctance on the part of Canadians to invest in equity stocks rather than in the more secure, and generally higher

yielding, fixed income investments. Should the recommendation on full integration not be adopted and individual rates continue to be higher than the corporate rate, then the individual should have the right to elect to bring one-half the capital gain into tax at marginal rates or to be taxed at the preferential rate of 25 per cent.

I subscribe to the provision of the Report with respect to gains realized on the sale of residential properties.

Trading profits will continue to be taxed at full rates, be they earned by the individual or by the corporation.

Finally, the Report considers and discards a "roll-over" provision with respect to realized property gains, on the grounds of deferment of tax and inequality of treatment of taxpayers. Nevertheless, the inclusion of a "roll-over" provision in the tax system might well be justified by the fact that the Canadian economy depends so much upon establishing secondary industry and increasing the sale of manufactured products abroad, particularly if there is to be deemed realization at death or on cessation of residence.

With respect to deemed realization, the Report provides for taxing unrealized gain in two important instances: (1) deemed realization on break-up of the family unit and (2) deemed realization on death of the surviving spouse. The reason for imposing a tax at this stage is to avoid deferment. In my opinion the latent hardships involved in such a policy, including forced sale of assets and double taxation on distribution, are far greater than any inconvenience to the Revenue which will collect its tax eventually. The decision whether or not to realize gains should be that of the taxpayer free from compulsion under the Income Tax Act. Therefore, to maintain neutrality the conclusion is: no taxation without realization except when a taxpayer ceases to be a resident of Canada unless, as the Report recommends, such taxpayer elected to be taxed as a Canadian resident on his world income.

GIFTS AND ANNUITIES

In the matter of taxing gifts generally, I would raise the annual exemption for individuals not within the family unit to $1,000. This takes into account that under the Report the tax burden moves from the donor to the donee and is on the accumulated total. Exemption in the amount stated also has administrative advantages.

At present the principal part of the payment under a contractual annuity is recognized as a return of capital and is not taxed. An annuity payable under a will or trust also defines the capital element and the income portion only is subject to tax. This treatment of annuities will cease if the comprehensive tax base is adopted although a contractual annuity established by way of gift, either inter vivos or testamentary, will be taxed on an "as and when received" basis if it is within the family unit or if it can be registered under a Registered Income Plan. In this connection it should be clearly established that if the present Estate Tax Act is to be retained, an annuity or pension payable to a widow should be valued on her life expectancy and the tax spread over the term with tax liability ceasing on the death of the annuitant.

REGISTERED RETIREMENT INCOME PLANS

Purchase of retirement savings under a Registered Retirement Income Plan should not be limited to an annual payment at retirement of $12,000, as recommended in the Report. To restrict the purchase of savings to this figure would mean a cutback in some of the Registered Retirement Income Plans now in existence, in both current and past service, and would fail to meet pension requirements for many in business and the professions where creative capacity must be recognized. In recommending a change in the present system, the Report is concerned with the inability of the authorities to prevent an overlapping of registered retirement plans which permits a contributor to participate in two or more plans; hence, the emphasis is placed on the

amount the participant will receive, and the burden of seeing that this amount is not exceeded is placed on the trustee of the registered plan. I do not recall witnesses taking any serious objections to the present system beyond expressing the belief that the present limits on contributions should be raised. Bearing in mind the factors of rising wages and salaries, this is fair comment, and I would retain the present system or, if policing it is an impossible task, I would raise the limit at retirement to $20,000, with a special provision for past service pensions.

COURT AWARDS AND COMPENSATION

I would also exempt from income tax an award of a court or tribunal granted as damages or compensation for loss of life, for total or partial disability or for loss of a member of the body; provided, however, that if the award includes the tax which would be paid under a comprehensive tax base, then the tax would be paid by the recipient of the award.

DEDUCTION FOR THE AGED

The Report would eliminate the deduction from taxable income of $500 now applicable under section 26(1)(e) and (f) of the Income Tax Act on grounds of inequity. The Report adds: "If some of these effects are considered undesirable, we believe they should be considered directly through transfer payments rather than obscured by altering the tax system." Removal of this deduction will be quite a serious matter since many low income taxpayers are dependent on some investment income to maintain their standard of living. Therefore, until suitable adjustments are made through transfer payments, section 26(1)(e) and (f) should be retained.

Respectfully submitted,

D. G. Grant
Commissioner

MEMORANDUM OF COMMISSIONER K. LeM. CARTER TO
REPORT OF THE ROYAL COMMISSION ON TAXATION

The Report (General Business Income, Chapter 22) states our concurrence in the view of The Canadian Institute of Chartered Accountants that tax legislation should contain no specific reference to accounting principles or practices in the determination of profit.

I concur in this statement in the Report for I consider that in this particular we should not depart from the authoritative opinion of an institution so closely associated with the point at issue.

My personal view does not accord with that of my profession for I prefer that the law state that profits for tax purposes should be determined in accordance with recognized accounting practices.

I choose the word "practices" rather than "principles" for the latter are the underlying rules that govern practice and the public is concerned only with practices. For its own particular purposes, tax legislation must continue to provide for departures from accepted accounting practices, but in my view they should be as few as possible and all set forth in the taxing statutes. The most obvious of the departures is capital cost allowances.

ACKNOWLEDGMENTS

We, the members of the Royal Commission on Taxation, in acknowledging the assistance and advice received, exclude all of the named persons and groups from responsibility for our conclusions and recommendations. We would have been incapable of discharging our duties without the help of the knowledgeable and courteous persons to whom this Report owes some of its finest value.

Our first acknowledgment must be to the large number of Canadians who showed their concern for this inquiry and gave us great help. Over three hundred briefs were submitted to us, and public hearings were conducted in eight provinces, in the Yukon and in the Northwest Territories. A goodly number of people had fairly strong views on taxation in one field or another and were not reluctant to make their ideas known. We are grateful for all the interest that has made our task rewarding and complete.

We were extremely fortunate in having Mr. J. L. Stewart, Q.C., his partner, Mr. S. E. Edwards, Q.C., and Mr. John M. Coyne, Q.C., as our legal counsel. Their invariable willingness to be of assistance at all times caused us to lean heavily on their advice. It is impossible to thank Mr. Stewart in conventional terms, and we hope that he is as pleased to be associated with the findings of the Commission as we have been in having had his services. Mr. Edwards relieved Mr. Stewart of some of the heavy duties and did this so readily that their services were interchangeable.

Professor Douglas G. Hartle was made available to us by the University of Toronto as our Director of Research. Professor Hartle, an economist with international experience, was indefatigable beyond obligation. He led a research staff of economists, lawyers and accountants who were completely devoted to their task, and worked together in the utmost harmony and with full respect for each other's disciplines.

Our thanks are due in full measure to Mr. P. Michael Pitfield and Mr. Gordon L. Bennett. They have guided the administrative staff with patience and understanding. Mr. Pitfield assisted in the original organization and provided a successful launching, while Mr. Bennett carried on during the period of our actual operations. The conscientious hard work of the members of both the research and administrative staffs deserves great praise. They are named in an accompanying list marked Appendix C. During the last few months Mr. Thomas F. Tyson and Professor Douglas J. Sherbaniuk were appointed as assistants to the Chairman to take charge of the multitudinous tasks involved in the final editing and physical processing of these volumes. Without their efforts the delay in publication would have been greater.

We are indebted to Mrs. Gwyneth McGregor, on loan from the Canadian Tax Foundation, and to Mr. Gerard Audcent, on loan from the Canadian Broadcasting Corporation, for the accomplished way in which this Report is edited and translated. Mrs. McGregor is both accurate and skilfully graceful in her writing. Mr. Audcent's reversible pen relieved us of one of the problems of the country in which we live. It became necessary to enlarge greatly the staff of French editors and we shall always be grateful to Professor Jacques Henry, Mr. Pierre Lemieux, and many others for the cheerful manner in which they undertook a truly formidable task.

Our appreciation goes to the many officials of the federal government departments and agencies. Particularly, we would like to thank the Deputy Minister of Finance; the Deputy Minister of National Revenue, Customs and Excise Division; the Deputy Minister of National Revenue, Taxation Division; the Governor of the Bank of Canada; the Secretary of State, Translation Bureau; and the President of the Canadian Broadcasting Corporation; all of whom permitted members of their staffs to serve in either research or administrative departments.

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- Riddell, Stead, Graham & Hutchinson, Ottawa
- Touche, Ross, Bailey & Smart, Montreal
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- Campney, Owen & Murphy, Vancouver
- Canadian Tax Foundation, Toronto
- Clarkson, Gordon & Co., Vancouver
- Fraser, Beatty, Tucker, McIntosh & Stewart, Toronto
- Goodman, Cooper, Cohen and Farano, Toronto
- Hanson, Rouse, Gilbert and Mockler, Fredericton
- Herridge, Tolmie, Gray, Coyne & Blair, Ottawa
- Lajoie, Gélinas, Lajoie, Bourque & Lalonde, Montreal
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- London School of Economics
- Manchester University
- McGill University
- Purdue University
- Queen's University
- Sir George Williams University
- University of Alberta
- University of British Columbia
- University of Illinois
- University of Michigan
- University of Montreal
- University of Ottawa
- University of Pittsburgh
- University of Toronto
- University of York, U. K.

During our travels across Canada we received many kindnesses. We were provided with suitable and comfortable quarters for our hearings by provincial, municipal, university and other authorities. The President of the Exchequer Court added stature to the Commission by granting a court room in the Supreme Court of Canada Building for our Ottawa hearings. We express our thanks to the members of the press, television and radio for their co-operation, which contributed substantially to the public interest.

Our debts of gratitude extend beyond the boundaries of our nation. We were fortunate to have had the opportunity of discussing tax problems with officials of the governments of the United States, whose tax problems are similar to our own, of the United Kingdom, Australia, New Zealand, France, Belgium, The Netherlands, Norway, Sweden, West Germany, Israel, Italy and Switzerland. From these conversations came innumerable items of help, which were given with the customary generosity accorded to interest in Canadian affairs.

We also had useful discussions with such eminent taxation authorities as Professor John Due of the University of Illinois, a specialist in sales tax; Professor Leif Mutén of Sweden, an authority on commodity taxes; Professor Carl Shoup of Columbia University, a member of the committee appointed by the Common Market countries to bring about an agreement of taxation within those countries; Professor Arthur Smithies of Harvard University; Mr. J. Van Hoorn, Jr., of Amsterdam, The Netherlands, Director of the International Bureau of Fiscal Documentation; Professor G.S.A. Wheatcroft of the London School of Economics; Professor Donald Macgregor of the University of Toronto; Mr. M. Boisvert, Q.C., and Mr. W. O. Davis, Q.C., both of the Tax Appeal Board. We are deeply grateful for the help of these enlightened gentlemen.

Our first acknowledgment was to those Canadians who submitted briefs or showed tangible interest in the Commission. Our last acknowledgment must also be to Canadians—to the members of government who indicated their faith in our ability to do a task that was not easy, and to those other members whose confidence has not evaporated with the time needed for the completion of this Report.

APPENDIX A

SUBMISSIONS RECEIVED FROM COMPANIES AND ORGANIZATIONS

A.G.F. Management Limited

Agricultural Institute of Canada 101

Air Transport Association of Canada

Alberta and Northwest Chamber of Mines and Resources

Alberta Wheat Pool

Anaconda American Brass Limited

Associated Factory Mutual Fire Insurance Companies

Association of Canadian Distillers

Association of Canadian Investment Companies, The

Association of Professional Engineers of the Province of Ontario

Atlantic Provinces Economic Council

Avon Products of Canada, Limited

Board of Evangelism and Social Service of the United Church of Canada

Board of School Trustees of School District No. 39 (Vancouver)

Board of Trade of Metropolitan Toronto, The

Brewers Association of Canada

British American Oil Company Limited, The

British Columbia Beef Cattle Growers' Association, The

British Columbia and Yukon Chamber of Mines, The 2

British Columbia Hotels Association, The

Calgary Power Ltd.

Canadian Air Line Pilots Association

Canadian Arthritis and Rheumatism Society, The

Canadian Association for Adult Education

Canadian Association of Equipment Distributors

Canadian Association of Real Estate Boards, The

Canadian Association of Social Workers

Canadian Association of University Teachers

Canadian Automobile Chamber of Commerce, The 122

Canadian Automotive Wholesalers' and Manufacturers' Association

Canadian Bankers' Association, The

Canadian Bar Association

Canadian Bottlers of Carbonated Beverages

Canadian Business Equipment Manufacturers Association 115

Canadian Business Service Limited, The

Canadian Chamber of Commerce

Canadian Committee on the Status of Women 74

Canadian Conference of the Arts

Canadian Construction Association

Canadian Co-operative Credit Society Limited

Canadian Co-operative Wheat Producers Limited

Canadian Copper & Brass Development Association 41

Canadian Dental Association 70

Canadian Electrical Association

Canadian Electrical Distributors Association

Canadian Electrical Manufacturers Association

Canadian Export Association

Canadian Federation of Agriculture

Canadian Federation of Business and Professional Women's Clubs, The

Canadian Federation of Government Employee Organizations, The

Canadian Federation of Insurance Agents & Brokers Association

Canadian Federation of Mayors and Municipalities 265

Canadian Federation of Property Owners Association and
Ontario Property Owners Association and
Property Owners Association of Metropolitan Toronto

Canadian Federation of University Women

Canadian Football League

Canadian Gas Association, The

Canadian Importers Association Inc. 183

Canadian Institute of Chartered Accountants, The

Canadian Jewellers Association

Canadian Labour Congress, The

Canadian Life Insurance Officers Association

Canadian Manufacturers' Association, The

Canadian Medical Association, The

Canadian Metal Mining Association

Canadian Museums Association

Canadian Mutual Funds Association

Canadian National Railways

Canadian Owners and Pilots Association, The

Canadian Pacific Railway Company

Canadian Peace Congress, The

Canadian Petroleum Association

Canadian Pharmaceutical Association Incorporated, The

Canadian Plumbing and Mechanical Contractors Association

Canadian Protestant League, The

Canadian Pulp and Paper Association

Canadian Rehabilitation Council for the Disabled

Canadian Research Committee on Taxation

Canadian School Trustees' Association

Canadian Section of the Council of Profit Sharing Industries

Canadian Shipowners Association

Canadian Tax Foundation

Canadian Teachers' Federation

Canadian Underwriters' Association

Canadian Union of Students

Canadian Universities Foundation

Canadian Utilities, Limited

Canadian Welfare Council, The

Canadian Western Natural Gas Company Limited and
Northwestern Utilities, Limited

Canadian Wholesale Council

Children's Apparel Manufacturers' Association

Citizens' Committee of Norman Wells

City Council of the City of Sydney, Nova Scotia, The

City of Edmonton, Purchasing Division, The

Club de Hockey Canadien and Maple Leaf Gardens Limited

College of General Practice of Canada

Commissioner of the Northwest Territories

Communist Party of Canada

Confectionery Association of Canada

Consumers' Association of Canada

Convention of Baptist Churches of British Columbia

Co-operative Union of Canada and Le Conseil Canadien de la Coopération

Council of the Forest Industries of British Columbia

Credit Union National Association, Inc.

Diversey Corporation (Canada) Ltd., The

Dominion-Scottish Investments Limited and
Economic Investment Trust Limited

Eddy Match Company Limited

Edmonton Chamber of Commerce

Electronic Industries Association of Canada

Equitable Income Tax Foundation, The

Farmers' Union of Alberta

Federated Co-operatives Limited

Federated Council of Sales Finance Companies, The

Financial Executives Institute of Canada (Canadian Affairs
Committee of the Controllers Institute of America)

Fisheries Association of British Columbia

Fraser Valley Milk Producers Association

Furman Construction Co. Ltd.

Governors of the University of Toronto, The

Graduate Student Association of the University of British Columbia

Grand Orange Lodge of British America, The

Grand Orange Lodge of Saskatchewan, The

Great Britain and Canada Investment Corporation

Heavy Construction Association of B.C., The

Hickman Tye Hardware Company Limited

Hiram Walker-Gooderham & Worts Limited

Hotel Association of Canada

Hotels Association of Saskatchewan

Imperial Oil Limited

Imperial Order Daughters of the Empire, The, and
Children of the Empire (Junior Branch)

Imperial Tobacco Company of Canada Limited

Independent Petroleum Association of Canada, The

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